NOTES

VALIDITY OF PREVAILING MINIMUM WAGE DETERMINATION UNDER THE PUBLIC CONTRACTS ACT*

PRIOR to the passage of the Walsh-Healey Public Contracts Act,[1] the Federal Government discouraged the improvement of labor standards in work on its supply contracts by a statutory requirement that such contracts be awarded to the lowest responsible bidder.[2] To make an attractive offer, eager bidders drove down labor costs; employers who disdained such practices frequently could not qualify. Embarrassed by the fact that it was encouraging wage "chiseling" on public contracts,[3] Congress provided in the Walsh-Healey Act that Government supply contracts should contain a stipulation by the contractor that all persons employed in the performance of the contract would be paid not less than the prevailing minimum wage.[4]

The determination of the rate of pay to be considered as the prevailing minimum wage is left to the Secretary of Labor, who administers the Act with the assistance of the Public Contracts Board. Investigations and findings concerning wage rates are made by the Board and submitted as a recommendation to the Secretary of Labor for final determination. The alternative standards to be used in ascertaining the wages are set forth in the Act: ". . . the prevailing minimum wages for persons employed on similar work or in the particular or similar industries or groups of industries operating in the locality in which the . . . supplies . . . are to be manufactured or furnished."[5] The Act neither defines "locality" nor presents a guide for

*Lukens Steel Co., *et al.* v. Perkins, *et al.*, No. 7368, (1939) 2 WAGE & HOUR REP. index p. 443 (App. D. C. 1939).

1. 49 STAT. 2036 (1936), 41 U. S. C. §§ 35-45 (Supp. 1938).

2. REV. STAT. § 3709 (1861), 41 U. S. C. § 5 (1934). The statute provides only that purchases and contracts for supplies and services shall be made by advertising. Judicial and executive construction have created the lowest responsible bidder requirement. The purpose of advertising is to secure competition so the Government may purchase at the lowest prices. Scott v. United States, 44 Ct. Cl. 524 (1909); Schneider v. United States, 19 Ct. Cl. 547 (1884); 22 OPS. ATT'Y GEN. 1 (1897). *See* Legis. (1937) 85 U. OF PA. L. REV. 297, 298.

3. This situation became particularly acute immediately following the invalidation of the N.R.A. in Schechter Poultry Corp. v. United States, 295 U. S. 495 (1935). The Government was forced to deal with contractors who had abandoned the Code standards for working conditions. *See Hearings before a Subcommittee of the Committee on the Judiciary on H. R. 11554,* 74th Cong., 2d Sess. (1936) 121 *et seq.* Contracting officers were compelled to accept the proposals from "bid-brokers" who would farm the contract out to the next highest bidder. The latter reduced wages to make profitable operations possible. *Id.* at 175, 208.

4. 49 STAT. 2036 (1936), 41 U. S. C. § 35 b (Supp. 1938). For a detailed analysis of both the legislative history of the Act, and of the standard of a prevailing minimum wage, *see* Comment, *The Determination of Prevailing Minimum Wages under the Public Contracts Act* (1939) 48 YALE L. J. 610.

5. 49 STAT. 2036 (1936), 41 U. S. C. § 35 b (Supp. 1938).

interpreting these standards. Presumably, therefore, the interpretation is to be left to the Secretary's discretion. The patent ambiguities in the statute seem to permit at least three different constructions. "In the locality" may modify only the last three standards, since the standard of "similar work" may be regarded as one which could not "operate" within a geographic area; or "in the locality" may qualify only its immediate precedent, "groups of industries;" or "in the locality" may be a general qualification of all the standards in the Act. The Secretary has regularly chosen the last alternative, that of general qualification, although actually only two of the standards — those of the particular or similar industries — have ever been used.[6] In applying these standards to given industries, the Secretary has adopted a broad definition of "locality," regarding it as a large geographic area, usually embracing several contiguous states, which has a uniform prevailing wage distinctly higher or lower than that of other sizeable areas.[7] In only seven of the thirty-three industries for which determinations have been made were geographic differentials recognized at all, and then the areas of uniform wages were of such magnitude that within an industry differentials were few.[8] The Secretary has established a single wage rate in the remaining twenty-six industries where no uniform and substantial differential was found to exist.[9]

The determination for the iron and steel industry,[10] which divides the United States into six large "localities" for the purpose of establishing geographic differentials, is the first to be attacked in the courts.[11] The complainants are small steel companies in eastern Pennsylvania, Maryland, and Connecticut whose wage rates are below the prevailing rate in the "Pittsburgh District," and are included in one "locality" with the "Pittsburgh District." The prevailing minimum wage established for this "locality" is the predominant rate of the "Pittsburgh District." Claiming that the expansion of "locality" to include great regional areas and the gerrymandering nature of

6. *See* Comment (1939) 48 YALE L. J. 610, 615. The recommendations of the Public Contracts Board to the Secretary of Labor in respect to the prevailing minimum wages in the iron and steel industry will be cited simply as Recommendations. Final determinations of the prevailing minimum wage by the Secretary of Labor in respect to a particular industry will be cited as *In re* . . . Industry.

7. *See* Comment (1939) 48 YALE L. J. 610, 624-628.

8. One industry is divided into four localities—the smallest "locality" covers three states. *In re* Fertilizer Industry, 3 FED. REG. 3804 (1939). In each of three industries the United States is portioned into three localities. *In re* Paper and Pulp Industry, 4 FED. REG. 4120 (1939); *In re* Dimension Granite Industry, 2 FED. REG. 2976 (1937); *In re* Furniture Mfg. Industry, 4 FED. REG. 1915 (1939). And for two industries, the differential separates two localities. *In re* Luggage and Saddlery Industries, 3 FED. REG. 1733 (1938); *In re* Men's Underwear Industry, 2 FED. REG. 1337 (1937).

9. Industries for which determinations have been promulgated form a good cross-section of the country's industrial pattern. Among some of the first industries were those that were notorious for their sweat-shop conditions. *See, i.e., In re* Cotton Garment and Allied Industries, 2 FED. REG. 1333 (1937); *In re* Men's Work Clothing Industry, 2 FED. REG. 223 (1937); *In re* Work Glove Industry, 2 FED. REG. 1339 (1937).

10. *In re* Iron and Steel Industry, 4 FED. REG. 265 *et seq.* (1939).

11. Lukens Steel Co., *et al.* v. Perkins, *et al.*, No. 7368 (1939) 2 W. & H. REP. index p. 443 (App. D. C. 1939).

the determination are arbitrary and capricious abuses of authority by the Secretary, the plaintiffs seek to enjoin the enforcement of the determination and to have it declared void.[12] The Secretary defends on the grounds, *inter alia,* that the determination is a valid exercise of discretion; that the action is against the United States without its consent; and that the plaintiffs have no standing to sue, since no legal right is injured by the determination. The District Court for the District of Columbia dismissed the complaint, but this decision was reversed by the Court of Appeals, which held against the Secretary on all contentions. An injunction was thereupon granted restraining the enforcement of the determination against all members of the iron and steel industry.[13]

The court states that the Secretary's determination is an abuse of authority because by "locality" Congress meant no more than a "local center of manufacture."[14] Support for this conclusion is reached chiefly by a resort to common usage of "locality." The court further states that since the statute is clear and unambiguous, the Secretary's interpretation is outside the bounds of administrative discretion. Because such reasoning nullifies not only the particular determination for the iron and steel industry, but make vulnerable to a similar challenge every other wage determination under the Act, the effects of the decision are far-reaching. The decision also squarely presents for the first time the question whether a prevailing minimum wage determination under the Walsh-Healey Act can be successfully challenged in the courts.

The court in the instant case tears the term "locality" from the context of the Act. The statute should be interpreted to facilitate its obvious aims[15] to raise the level of sub-standard labor conditions of workers on government contracts and to prevent competition among government contractors from becoming a force compelling the reduction of wages.[16] The court's definition

12. Prior to the Act these companies had received substantial awards of Government contracts. Record, pp. 4-7, Lukens Steel, *et al.* v. Perkins, *et al.*, No. 7368, (1939) 2 W. & H. REP. index p. 443 (App. D. C. 1939). Subsequent to the *Lukens Steel* decision the plaintiffs have again made contracts with the Government for iron and steel commodities. Communication to YALE LAW JOURNAL by counsel for plaintiffs, Nov. 30, 1939.

13. If the court enjoined enforcement of the determination only as against the parties, the plaintiffs would be able to secure contracts with different stipulations than the contracts of competitors who were not parties to the suit. Such inequality would make any contracts the plaintiffs might obtain of doubtful validity.

14. Lukens Steel Co., *et al.* v. Perkins, *et al.*, No. 7368, Preliminary Opinion, p. 5. The court concedes that the meaning of "locality" is somewhat indefinite, but states that the Secretary's interpretation goes beyond any possible proper application of the word. It is implicit within the decision that "in the locality" qualifies all standards for wage determinations.

15. *Cf.* Royal Indemnity Co. v. American Bond & Mortgage Co., 289 U. S. 165, 169 (1933); United States *ex rel.* Anderson v. Anderson, 76 F. (2d) 375, 378 (C. C. A. 8th, 1935).

16. *See Hearings before Subcommittee of House on Judiciary on H. R. 11554,* 74th Cong., 2d Sess. (1936) 222-224 (statement by Secretary of Labor Perkins); 80 CONG. REC. 10002 (1936) (statement by Representative Healey); STRACKBEIN, THE PREVAILING MINIMUM WAGE STANDARD (1939) 32-35; Comment (1939) 48 YALE L. J. 610, 611; Legis. (1937) 37 COL. L. REV. 102, 104-106.

of "locality" discloses either a failure to recognize the purpose of the Act or an unrealistic conception of the steel industry. The Public Contracts Board does not establish a hypothetically fair wage but adopts the existing predominate minimum wages in the particular industry.[17] Consequently, the prevailing minimum wage is a flexible rate controlled from within the industry. Under the court's interpretation, when there is only one possible bidder in a local center of manufacture, as is the case in a majority of the steel plants in the United States,[18] he would be able to determine his own prevailing minimum wages.[19] Further, no effect would be given to the fact that lower wage rates give a manufacturer or manufacturers in one section an important competitive advantage over manufacturers in distant sections with higher rates.[20] The result is that many employers, who might pay higher wages, will drive down labor costs to meet their competition. The restricted definition of "locality" in the *Lukens Steel* decision is thus objectionable, since it preserves the status quo of manufacturers in geographically isolated centers, permits the destructive competition to continue as a depressant on labor conditions, and, consequently, impairs the corrective purposes of the Act. On the other hand, these purposes are achieved by the Secretary's interpretations. The prevailing minimum wage level of the entire industry, with geographic differentials when desirable, eliminates sub-standard wage practices by government contractors, and denies any unfair competitive advantage that may result from low wage costs.

17. The sources of the statistics collected by the Board show that wage rates relevant to standards of "similar work" or "groups of industries" have not been considered; "similar industries" has been used in but few instances. These standards were rejected because a comparison of one work with "similar work" or one industry with a "similar industry" or "groups of industries" presents severe practical obstacles; the results would also be highly speculative since satisfactory similarities are difficult to ascertain. The Act's purpose is not fully served by a comparison of non-competitive manufacturers. *See* STRACKBEIN, *op. cit. supra* note 16, at 40–68.

18. 234 iron and steel plants furnished testimony before the Public Contracts Board. Approximately 130 of these plants are in local centers of manufacture. Recommendations (1938) 68, 69, 78-84.

19. *E.g.*, the situation in New Jersey will exemplify this problem. There are three distinct centers of manufacturers in the state. One center pays a base rate of 56½c. (two plants); a second district pays a base rate of 62½c. (one plant); the third center (one plant) pays a base rate of 50c. Recommendations 44, 45 (1938). These centers obviously would be unaffected by a wage determination based on the prevailing wages in their own centers. Further illustration of the impotence of the Act under the court's definition of "locality" is that the seven plants in the industry paying the lowest wages are all in geographically isolated centers. *Id.* at 78-84.

20. Evidence of the widespread sweep of the market in the iron and steel industry is that for some purposes the entire United States provides a competitive area for manufacturers. Recommendations 116-118 (1938). The distance of customers from the Pittsburgh basing points has determined the extent of the market and not the distance of the producers from the customers. *See* FTC REP. TO THE PRES., Nov. 30, 1934; FTC Release No. F-6, March 7, 1939. Although the old basing point system has been abandoned, there has been no appreciable alteration of marketing conditions in the steel industry. *See In re* Iron and Steel Industry, 4 FED. REG. 267 (1939).

A further objection to the court's position is that it imposes obstacles which prohibit practical administration of the Act. The prevailing minimum wages for supply contracts must be determined prior to the call for bids.[21] If the court's definitions of "locality" be accepted, an accurate determination of the predominant minimum wage will require that the administrators ascertain the prevailing minimum wages in the hundreds of local centers of manufacture in each industry whence bids may be submitted. Since the fluctuation of wages is more sharply reflected in a local center, a separate investigation of all centers of manufacture might be required each time bids were to be accepted for a government contract.[22] When a large regional area is selected, however, the fluctuation of wages in one local center tends to counterbalance an opposite fluctuation in another center in the same area. Readjustment of a determination is thus necessary only when there is a long-range change in the general wage level. It would seem that Congress did not intend "locality" to be restricted to the court's definition, since Congress certainly did not propose to impose an overwhelming burden upon the administrators of the Act.

After deciding that the interpretation of "locality" by the Secretary was arbitrary and capricious, the court relies on this abuse of authority to remove the case from the category of suits against the United States without its consent. An approach on these grounds vitiates the doctrine of sovereign immunity on the very occasion it is most significant. Sovereign immunity may be violated, of course, even though the suit is nominally against a public official.[23] The determinative factor, except when the action is founded on a constitutional challenge,[24] is whether the suit affects the United States.[25] Applying this criterion, a well-established line of cases holds that, without sovereign consent, there can be no suit against a public officer for damages[26] or for specific performance,[27] when he refuses to perform an existing con-

21. 49 STAT. 2036 (1936), 46 U. S. C. § 35 a (Supp. 1938).

22. *See In re* Iron and Steel Industry, 4 FED. REG. 265, 266 (1939). Representations pursuant to the Act have been made in 17,857 contracts; of this number, 1,875 contracts were for iron and steel commodities. Communication to YALE LAW JOURNAL by L. Metcalfe Walling, Administrator of Public Contracts Division, Nov. 15, 1939.

23. *In re* Ayers, 123 U. S. 443, 487 (1887); Poindexter v. Greenhow, 114 U. S. 270, 287 (1884).

24. As in *Ex parte* Young, 209 U. S. 123 (1908).

25. Morrison v. Work, 266 U. S. 481 (1925); Haskins Bros. v. Morgenthau, 85 F. (2d) 677 (App. D. C. 1936).

26. Lynch v. United States, 292 U. S. 571 (1934); United States v. Babcock, 250 U. S. 328, 331 (1919); *see* SHEALEY, THE LAW OF GOVERNMENT CONTRACTS (3d ed. 1938) 10. The United States has consented to be sued for contract claims in the Court of Claims. 24 STAT. 505 (1887), 28 U. S. C. § 250 (1) (1934).

27. Specific performance is never granted since the court would, in effect, be directing the conduct of the Government's business. Wells v. Roper, 246 U. S. 335 (1918); Transcontinental & Western Air, Inc. v. Farley, 71 F. (2d) 288 (C. C. A. 2d, 1934), *cert. denied*, 293 U. S. 603 (1934). A petition for a writ of mandamus against the officer cannot accomplish indirectly the effect of specific performance. United States *ex rel.* Shoshone Irr. Dist. v. Ickes, 70 F. (2d) 771 (App. D. C. 1934). This situation approximates a political question.

tract or prohibits further performance by the contractor. A party's interest in a contracting officer's observance of the sanctity of an existing contract is certainly of greater importance than the right to have the officer lawfully determine a condition for a future contract. Since the courts in the breach of contract cases either assume that the officer's conduct is unlawful or do not consider the question, no reason appears why the legality of the Secretary's conduct should be relevant in the instant case. An apparent exception to the doctrine of sovereign immunity, however, grants relief when there has been an illegal interference with "vested" rights.[28] While it is possible to argue that the plaintiffs' interest in freedom from alleged unlawful interference when they are negotiating for contracts is sufficiently "vested" to bring them within the exception,[29] this conclusion seems to conflict with the authority that bars a suit against the United States for breach of contract.

If the complainants can overcome the apparent obstacle of sovereign immunity as they did in the instant case, the question then arises whether they have sufficient legal interest to challenge a wage determination. An analysis of the legal principles applicable to a potential bidder's interest to negotiate for government contracts leads to the conclusion that there are no doctrinal objections to his standing in court. Since no express provision of the Act either grants or denies a prospective bidder a review of a determination of prevailing minimum wages,[30] the right to sue must come from the general jurisdiction of the federal courts.[31] It is well established that no person has a legal right to challenge the conditions on which public work is made

28. Lipke v. Lederer, 259 U. S. 557 (1922) (unlawful seizure of goods); Noble v. Union River Logging R. R., 147 U. S. 165 (1893) (acts constituting cloud on title); Lane v. Watts, 234 U. S. 525, 540 (1914) (unlawful entry on land).

29. *See* note 36 *infra*.

30. § 5 of the Act authorizes the Secretary upon his own motion or on application of any person affected by any ruling of any agency to hold hearings and make findings which shall be conclusive if supported by the preponderance of the evidence. 49 STAT. 2038 (1936), 41 U. S. C. § 39 (Supp. 1938). This section implies judicial review of prosecutions for violations of the Act; but Congress probably did not intent to include review of the wage determinations authorized in § 4. 49 STAT. 2038 (1936), 41 U. S. C. § 37 (Supp. 1938). Support for findings by a preponderance of the evidence is essential protection to a violator but would be an unusual burden for an administrative finding. *Cf.* 49 STAT. 453 (1935), 29 U. S. C. § 160 f (Supp. 1938) (supported by evidence); 52 STAT. 1065, 29 U. S. C. A. § 210 (Supp. 1938) (supported by substantial evidence). Employees, the immediate beneficiaries of the Act, are given no right to challenge a determination. *See* note 42 *infra*. If the subpoena power in § 5 were available for use in determining wages, an unnecessary and possibly invalid inquisitorial power over all industry would be given to the Secretary. *See* Harriman v. I. C. C., 211 U. S. 407, 417 (1908). Subpoenas have never been used in connection with wage determinations. Communication to YALE LAW JOURNAL by Administrator of Public Contracts Division, Nov. 15, 1939. Since the Act was passed as a direct result of the invalidation of the NRA in Schechter Poultry Corp. v. United States, 295 U. S. 495 (1935), it is unlikely that Congress intended its new effort to be subjected to judicial scrutiny. *See* Comment (1939) 48 YALE L. J. 610, n. 3.

31. *Cf.* Rochester Telephone Corp. v. United States, 307 U. S. 125 (1939); Shields v. Utah Idaho Central R. R., 305 U. S. 177 (1938); *see* (1939) 48 YALE L. J. 1257.

available by sovereign authority.[32] The Government's power to control its own working conditions is not limited by the restrictions on its authority to regulate similar conditions in private enterprise.[33] It does not follow, however, that since a person has no right to work for the Government that he also has no right to challenge the Secretary's determination. It is necessary to distinguish between the power of Congress to impose such conditions as it sees fit for public contracts, and the alleged lack of authority of the Secretary to impose additional restrictions not authorized by law, which interfere with or obstruct a bidder in his efforts to do business with the Government.[34] The value of an interest to negotiate with the Government as a prospective customer is no less than the value of an interest to negotiate with a customer who is a private person.[35] Protection from unlawful interference in the latter situation is not denied on the ground that the party seeking protection could not compel the customer to deal with him or could not object to the conditions established by the customer if the party wishes to enter contractual relations.[36] Consequently, the absence of a right to make a direct attack on the constitutionality of the Walsh-Healey Act is not determinative in a consideration of the plaintiffs' right to challenge the Secretary's determination.

This conclusion apparently controls the question relating to the speculative character of the complainants' injuries. No contractor's privilege to bid has been denied; even if he does bid, there is no assurance of acceptance. The most serious effect an unlawful wage determination may have is to destroy a possible profit of a potential bidder. The Secretary's argument, however, that there is no irreparable injury because complainants cannot

32. Atkin v. Kansas, 191 U. S. 207 (1903); Ellis v. United States, 206 U. S. 246 (1906); Heim v. McCall, 239 U. S. 175 (1915); Rok v. Legg, 27 F. Supp. 243 (S. D. Cal. 1939); *cf.* Jacobsen v. Massachusetts, 197 U. S. 11, 31 (1905). *But see* Powell, *The Right to Work for the State* (1916) 16 COL. L. REV. 99. Mr. Powell contends that Heim v. McCall, *supra,* denies aliens the equal protection of the laws.

33. Compare Heim v. McCall, 239 U. S. 175 (1915) (regulation of aliens), with Truax v. Raich, 239 U. S. 33 (1915) (same); compare Ellis v. United States, 206 U. S. 246 (1906) (regulation of maximum hours), with Schechter Poultry Corp. v. United States, 295 U. S. 495 (1935) (same).

34. Weinstein Building Corp. v. Scoville, 141 Misc. 902, 254 N. Y. Supp. 384 (Sup. Ct. 1931); Ames v. Wallace, 1 S. C. D. C. (N. S.) 238 (Sup. Ct. D. C. 1935), *aff'd on other grounds,* 81 F. (2d) 414 (App. D. C. 1935); *see* Gillioz v. Webb, 99 F. (2d) 585, 586 (C. C. A. 5th, 1938); United States *ex rel.* Johnston v. Morley, 17 F. Supp. 378, 388 (W. D. N. Y. 1936); 28 OPS. ATT'Y GEN. 384, 389 (1910).

35. Government purchases under the Walsh-Healey Act constitute a significant market. As of Oct. 28, 1939, approximately $1,397,577,000 worth of contracts has been awarded subject to the Act. Of these contracts, approximately $110,400,000 worth was for iron and steel products. Communication to YALE LAW JOURNAL by L. Metcalfe Walling, Administrator of Public Contracts Division, Nov. 15, 1939.

36. Truax v. Corrigan, 257 U. S. 312, 327 (1921); Dehydro, Inc. v. Tretolite Co., 53 F. (2d) 273 (N. D. Okla. 1931); Crescent Mfg. Co. v. Mickle, 216 Fed. 246 (D. Ore. 1914); Pratt Food Co. v. Bird, 148 Mich. 631, 112 N. W. 701 (1907). The Secretary's defense that the contractors could do business elsewhere is analogous to the old arguments used to support the "yellow-dog" contracts (that employees could seek work elsewhere). *See* Coppage v. Kansas, 236 U. S. 1, 11 (1915).

prove that they would secure contracts, begs the basic question whether they have a privilege to negotiate for contracts.[37] If bidders have this privilege to attempt to enter into business relations with the Government, it is not necessary to show that such negotiations would be successful.[38] The gravamen of the complaint is the alleged interference with the privilege of bidding. Although the difficult part of the plaintiffs' proof is to show that the alleged unlawful wage determination would raise costs to such an extent that they are prevented from bidding, as a practical matter the effect of the wage determination would be directly reflected in their profits because their previous wage rates were below the level set by the determination. It would be a denial of the Act's efficacy to claim that the existing wage rates of the plaintiffs are not affected by a wage determination.[39]

In ostensible conflict with a recognition of any legal interest in the complainants is the settled rule that since a lowest responsible bidder statute is enacted for the benefit of the taxpayers and not for the contractor, a rejected bidder cannot challenge the legality of the award of a Government contract.[40] Considerations of public policy lie behind the rule, for granting an injunction against the award of a contract may paralyze vital functions of Government business. But these issues are not relevant in the attack on the wage determination under the Walsh-Healey Act, since the complainants are not seeking to compel the award of the contracts to themselves but are asserting their privilege to be free from alleged unlawful interference in negotiating for contracts.[41] Unlike a lowest responsible bidder statute, the Walsh-Healey Act was not passed for the taxpayers' benefit, since the Act may actually increase the cost of supplies furnished the Government. Its beneficiaries, primarily, are the employees of government contractors[42] and,

37. When proof of irreparable injury is necessary to establish the invalidity of an administrative ruling, it is because regulation that is originally lawful becomes unlawful only when "turned into an act of tyranny." The question of standing to sue is not involved. Hegeman Farms Corp. v. Baldwin, 293 U. S. 163, 170 (1934); California v. Latimer, 305 U. S. 255, 260 (1938).

38. Truax v. Raich, 239 U. S. 33 (1915); *cf.* Pierce v. Society of Sisters, 268 U. S. 510 (1925). Unlawful interference with an opportunity for a prize or gratuity will support an action for damages. 4 RESTATEMENT, TORTS (1939) § 912 f; Keegle v. Hickeringill, 11 East 574 (K. B. 1809); *see* Jersey City Printing Co. v. Cassidy, 63 N. J. Eq. 759, 53 Atl. 230 (1902); Lewis v. Corbin, 195 Mass. 520, 81 N. E. 248 (1907); Comment (1935) 48 HARV. L. REV. 984.

39. *See* Comment (1939) 48 YALE L. J. 610, 629 *et seq.*

40. O'Brien v. Carney, 6 F. Supp. 761 (D. Mass. 1934); United States Wood Preserving Co. v. Sundmaker, 186 F. 678 (C. C. A. 6th, 1911); Talbot Paving Co. v. Detroit, 109 Mich. 657, 67 N. W. 979 (1896); *see* American Smelting and Refining Co. v. United States, 259 U. S. 75, 78 (1922); 3 MCQUILLAN, MUNICIPAL CORPORATIONS (2d ed. 1923) § 1286. A bidder's suit in his capacity as a taxpayer would not be successful. Massachusetts v. Mellon, 262 U. S. 447 (1923); Wheless v. Mellon, 10 F. (2d) 893 (App. D. C. 1926).

41. *See* note 36 *supra.*

42. *See* note 3 *supra.* When a labor union claims that the wage determination for state construction works is not the prevailing rate, the court may take judicial notice that some members of the union would be employed on the works. Denver Bldg. & Const. Trades Council v. Vail, 103 Colo. 364, 86 P. (2d) 267 (1939). The broader and more

partly, the contractors themselves.[43] Nor are the policy considerations of the cases on lowest responsible bidder statutes here applicable. Although an injunction against the enforcement of a wage determination interferes with the effort to affect wage standards, it is not an interference with the uninterrupted supply of government necessities, because new contracts can immediately be let without the wage representations.[44]

A further question bearing on the sufficiency of the complainants' legal interest is whether they are seeking to be free from impairment of their competitive position. If the unlawful act of an administrative officer gives a competitive advantage to one class of persons that enables them to damage their competitors, it is *damnum absque injuria.*[45] The basis of this rule is that the unlawful act has not affected the objector except through the indirect result of lawful competition. The objector is held to have no right to be free from lawful competition[46] or to maintain an existing competitive advantage,[47] for he has the alternatives of combatting the lawful competition on his own terms or to discontinue business operations.[48] The complainants in *Lukens Steel v. Perkins,* however, are not objecting to an act of the Secretary which through its effect on third parties creates destructive com-

uncertain field of supplies for the national government probably prohibits the use of this technique for federal contracts.

43. The Government had received numerous objections from employers who were underbid by persons maintaining sub-standard labor conditions. *Hearings before a Subcommittee of the Committee on the Judiciary on H. R. 11554,* 74th Cong., 2d Sess. (1936) 442, 529, 530.

44. The minimum wage provisions of the Walsh-Healey Act apply only to contracts relating to industries that are the subject matter of a determination by the Secretary of Labor. 49 STAT. 2039 (1936), 41 U. S. C. § 45 (Supp. 1938). Subsequent to *Lukens Steel v. Perkins,* contracts for iron and steel commodities have been awarded without minimum wage representations by the contractor, conditional or otherwise. Communication to YALE LAW JOURNAL by L. Metcalfe Walling, Nov. 18, 1939. A possible detriment to the Government is that contractors paying high wages will not bid; and there is a presumption that well paid employees perform better work. *Hearing before a Subcommittee of the Committee on the Judiciary on H. R. 9745,* 75th Cong., 3d Sess. (1938) 139 (Statement by Mr. Walling); *see* Wagner v. Milwaukee, 180 Wis. 640, 644, 192 N. W. 994, 996 (1923), *writ of error dismissed,* 266 U. S. 585 (1924); *cf.* (1938) 47 YALE L. J. 832, 835.

45. Tennessee Electric Power Co. v. Tennessee Valley Authority, 306 U. S. 118 (1939); Alabama Power Co. v. Ickes, 302 U. S. 464 (1938). *But cf.* Frost v. Corp. Comm'n, 278 U. S. 515 (1929) (*semble*). *See* Comment (1938) 51 HARV. L. REV. 897. This rule would apparently control the case of an attack on a determination on the ground that it was *below* a competitor's actual prevailing minimum wage.

46. Puget Sound Power & Light Co. v. Seattle, 291 U. S. 619, 626 (1934); Madera Water Works v. Madera, 228 U. S. 454 (1913); *see* Railroad Company v. Ellerman, 105 U. S. 166, 173 (1881). *But cf.* The Chicago Junction Case, 264 U. S. 258, 266 *et seq.* (1924); Texas & Pacific Ry. v. Gulf C. & Sante Fe Ry., 270 U. S. 266, 273 (1926).

47. Sprunt & Son, Inc. v. United States, 281 U. S. 249 (1930); Edward Hines Trustees v. United States, 263 U. S. 143 (1923); *see* United States v. Merchants & Manufacturers Traffic Ass'n, 242 U. S. 178, 189 (1916).

48. For this type reasoning *see* Hegeman Farms Corp. v. Baldwin, 293 U. S. 163, 171 (1934).

petition. Their objection rests on the claim that there is a direct and immediate unlawful interference with their own operations.

If the complainants, as prospective bidders, are unable to challenge the validity of a wage determination before they submit a bid, every possible avenue of attack is closed. A tolerance section in the Act allows exemptions before a contract is made, but this privilege arises only when the public convenience so requires, and upon a motion by the Government.[49] A bidder must wait for acceptance of his proposal before exemptions are available on his own motion.[50] If the bid were submitted without all required stipulations it would be rejected.[51] After rejection, the contracting officer could not be restrained from awarding the contract to a third party, nor could he be mandamused to award the contract to the petitioner.[52] If a proposal included the required stipulations and is accepted, the bidder, as a recipient of benefits, would be estopped from an attack on the validity of a determination.[53]

Although it appears that doctrinal precedent is not available to deny the steel companies standing to sue, an obstacle might be presented by a forthright emphasis on considerations of public policy. The Secretary of Labor is the agent and subordinate of Congress for the determination of conditions in Government contracts. Since the expressed will of Congress is the supreme law in the domain of public contracts, the courts might well withdraw on the ground that the supervision of government contracting agents is a duty of Congress and not of the courts. The likelihood of such a power-renouncing attitude, however, is diminished by analogous situations where the complainant is granted a privilege subject to the absolute control and discretion of Congress. Where there is an alleged unlawful interference by an executive

49. 49 STAT. 2038 (1936), 41 U. S. C. § 40 (Supp. 1938).

50. *Ibid.* The plaintiffs requested that the hearing before the Board be reopened, made objections to the Recommendation before the Secretary, and sought postponement of the effective date of the determination. Record, pp. 20-24, Lukens Steel Co., *et al.* v. Perkins, *et al.*, No. 7368 (1939) 2 WAGE & HOUR REP. index p. 443 (App. D. C. 1939). These actions probably exclude plaintiffs from requirement that though no specific administrative remedy is available, relief should be sought first from the administrative officers. Peterson Baking Co. v. Bryan, 290 U. S. 570 (1934); Goldsmith v. Board of Tax Appeals, 270 U. S. 117 (1926); *see* Red "C" Oil Mfg. Co. v. North Carolina, 222 U. S. 380, 394 (1912); *cf.* Myers v. Bethlehem Corp., 303 U. S. 41, 50 *et seq.* (1938).

51. 49 STAT. 2036 (1936), 41 U. S. C. § 35 b (Supp. 1938).

52. *See* note 40 *supra.*

53. St. Louis Malleable Casting Co. v. Prendergast Const. Co., 260 U. S. 469 (1923); Daniels v. Tearney, 102 U. S. 415 (1880); *cf.* United Fuel Gas Co. v. Railroad Comm. of Kentucky, 278 U. S. 300, 308 (1929); *see* Comments (1939) 48 YALE L. J. 610, 628, (1934) 34 COL. L. REV. 1495. An intentional violation of a minimum wage stipulation in order to test the validity of a wage determination is impractical since the Act permits an immediate cancellation of the contract and the party responsible therefor is liable for liquidated damages. Also, the Comptroller General is authorized to "blacklist" any violator, for three years. 49 STAT. 2037 (1936), 41 U. S. C. §§ 36, 37 (Supp. 1938). The Act, however, has been satisfactorily enforced without resort to the "blacklisting" provisions. *Hearings before a Subcommittee of the Committee on the Judiciary on H. R. 9745*, 75th Cong., 3d Sess. (1938) 140 (Statement by Mr. Walling).

officer with a party's use of this privilege, the courts in these cases recognize a sufficient legal interest for a standing to sue.[54]

If plaintiffs have standing in court, to what extent should the court review the Secretary's determination? The range of judicial surveillance over official acts executing unlimited powers of Congress is confined within narrow limits. In cases involving these powers it is frequently held that the administrative officer's definition of terms and statutory constructions are final and conclusive.[55] The need for administrative finality is equally compelling in the field of Government contracts, as the facts in the instant case well disclose. A fairly uniform differential exists between the lower wage rates in the iron and steel plants along the Atlantic seaboard, and those paid in the "Pittsburgh District."[56] The majority of the Public Contracts Board refused to recommend a differential on the grounds that the competitive advantage of the lower wage area would endanger the higher wage level in the other district. The minority stated that this differential should be recognized and relied on the fact that the lower wage area had not received an undue proportion of government contracts in the past. Despite arguments concerning the propriety of the Secretary's determination a comparison of the conflicting recommendations clearly illustrates that delimiting the boundaries of a "locality" calls for elements of judgment that are extraneous to the statistical aggregates. The meaning of "locality" is not so definite and certain[57] that

54. Philadelphia Co. v. Stimson, 223 U. S. 605, 620 (1912) (harbor power); American School of Magnetic Healing v. McAnnulty, 187 U. S. 94 (1902) (postal service); Waite v. Macy, 246 U. S. 606 (1918) (customs); Red Canyon Sheep Co. v. Ickes, 98 F. (2d) 308 (App. D. C. 1938) (government land).

55. *E.g.*, when discretion is required, the Land Department's definitions of terms and statutory interpretations are conclusive. Ness v. Fisher, 223 U. S. 683 (1912); United States *ex rel.* Riverside Oil Co. v. Hitchcock, 190 U. S. 316 (1903); Heath v. Wallace, 138 U. S. 573 (1891); *see* DICKINSON, ADMINISTRATIVE JUSTICE AND THE SUPREMACY OF LAW (1927) 277 *et seq.* The Comptroller General's discretionary decisions are final notwithstanding probable errors of fact or law. Adams v. Nagle, 303 U. S. 532 (1938). A bidder's interest in government contracts is no greater than his interest in unrestricted access to the postal facilities. Yet, the courts presume that questions of law are correctly decided by the Post-Office Department and will sustain the exercise of discretion unless the decision is a rational impossibility. Public Clearing House v. Coyne, 194 U. S. 497 (1904); Bates & Guild Co. v. Payne, 194 U. S. 106 (1904); *accord*, Louisiana v. McAdoo, 234 U. S. 627 (1914) (tariff); Bartlett v. Kane, 16 How. 263 (U. S. 1853) (customs); *but cf.* American School of Magnetic Healing v. McAnnulty, 187 U. S. 94 (1902).

56. In the "Pittsburgh district" and the Mid-Western area the companies that employ 81% of the total number of workers paid common labor a base rate of 62½c. an hour. In the states along the Atlantic seaboard the plants that employed 71% of all workers paid 56½c. an hour as a base rate. Recommendations, 142-143 (1938). This 6c. differential, plus a fair uniformity of wage levels in the respective regions appear to fulfill established requisites for geographic differentials. *See* note 7 *supra*. The plaintiffs' objections to the determination rest on the failure of the Secretary to recognize this differential. These districts were consolidated in the determination because the 62½c. rate numerically predominated the combined areas. *In re* Iron and Steel Industry, 4 FED. REG. 265, 268 (1939).

57. Locality may mean a district of "undefined extent." 6 NEW ENGLISH DICTIONARY ON HISTORICAL PRINCIPLES (1908) 380 (4b). The United States Supreme Court has held

the Secretary's interpretation may be called a rational impossibility or an act in bad faith.[58] The Secretary's functional definition, taking cognizance of the purposes and administrative requirements of the Act, should therefore, in the absence of a showing of bad faith, be conclusive.

RIGHTS OF PERFORMERS AND RECORDERS AGAINST UNLICENSED RECORD BROADCASTS*

IN 1937 the Supreme Court of Pennsylvania, in the celebrated *Waring* case,[1] recognized a performer's property right in his musical renditions by enjoining a radio station from making unlicensed broadcasts[2] of his records. A logical sequence to the result there reached is a recent federal decision, *R. C. A. Manufacturing Company v. Whiteman*,[3] which extends to record manufacturers the right to enjoin unauthorized broadcasts of their products. Since the court found that the recording process, unlike the performer's style of playing, was not such an artistic creation as might be deemed an intellectual property right,[4] RCA's injunction against the offending station

that the meaning of locality in a state construction contract statute was too uncertain to be a basis for criminal penalties. The court stated that the word's connotation depended upon the circumstances of its use; and further stated that a locality may *include* areas. Connally v. General Construction Co., 269 U. S. 385, 395 (1926). These statements may authorize an even more liberal construction of locality in the federal statute which, of course, is free from the territorial limits of a state statute. *But cf.* Texas & P. Ry. v. United States, 289 U. S. 627, 638 (1933).

58. Since the first determination under the Act (over two years prior to *Lukens Steel v. Perkins*), was determined without regard to local differentials and the Secretary has always considered a "locality" as a great regional area, the silence of Congress may imply acquiescence. *See* Norwegian Nitrogen Co. v. United States, 288 U. S. 294, 313 (1933); United States v. Jackson, 280 U. S. 183, 193 (1930); *Hearings before a Subcommittee of the Committee on the Judiciary on H. R. 9745*, 75th Cong., 3d Sess. (1938) 139 (question by Representative Healey).

*RCA Manufacturing Co. v. Whiteman, 28 F. Supp. 787 (S. D. N. Y. 1939).

1. Waring v. WDAS, 327 Pa. 433, 194 Atl. 631 (1937).

2. The court found in Waring's rendition an artistic creation giving rise to an intellectual property right, or "common law copyright," and that therefore Waring could enjoin unlicensed broadcasts of his records by Station WDAS. Although traditionally the general publication of an artist's work effected an abandonment of his rights, Waring's intent to prohibit broadcasting, as manifested by restrictive labels placed on each record sold, preserved them here.

An alternative ground for the injunction was that the broadcasts constituted unfair competition with Waring, principally because they detracted from his prestige with radio sponsors, and also because they reduced his record sales by overfrequent playings and by indiscriminate selection which included defective and outmoded records.

3. 28 F. Supp. 787 (S. D. N. Y. 1939).

4. RCA (formerly Victor) had vigorously asserted that its recording process was a work of talent, since, as admitted by Toscanini and other conductors, an adequate recording without the surveillance of acoustical experts was impossible. Communication

was based upon the manufacturer's right to be protected against unfair competition and upon the performer's rights which were assigned to RCA.[5]

Apart from the legal issues presented by the *Waring* and *Whiteman* decisions,[6] their practical results should be examined, for they have highlighted manifold difficulties in the enforcement of the rights of performers and recorders. Assuming the conclusion of both courts, that such protection is desirable, the actual value of the safeguards afforded by these decisions becomes questionable upon a factual analysis of their effect in the musical recording field.[7] First, the specific remedy authorized by the courts, the injunction, affords but negligible protection to either group. Laborious proof of injury is necessary in each case; and even if an injunction be obtained, only the particular station involved is affected by it and then only to the extent that it must cease broadcasting a few designated records. Owing to the short life of most popular records, the harm is usually done before the injunction can issue. Moreover, the legal remedy of damages is not feasible because of insurmountable difficulties of proof as to the pecuniary loss suffered. If it is extremely difficult to prove that a particular broadcast results in waning commercial reputation or declining record sales, it is obvious that it is even more difficult to measure the financial loss involved. The futility of court action is shown by the fact that only five suits have been brought against unlicensed users of records,[8] and their cumulative effect has not been

to YALE LAW JOURNAL from counsel for RCA, Sept. 25, 1939. Littauer, *Present Legal Status of Artists, Recorders, and Broadcasters in America* (1938) 3 GEISTIGES EIGENTUM 217, 230.

5. RCA sought to enjoin unlicensed broadcasts by WNEW and to enjoin Whiteman from representing to radio that he, by the terms of his recording contracts with RCA, had the sole right to license broadcasts. Both injunctions were granted. The court found, on the *Waring* doctrine, that Whiteman had both a property right in his renditions and a right against unfair competition, but that in two of the three contracts involved, these rights were assigned to RCA. However, even in this case it was held that RCA had independent rights based on the doctrine of unfair competition. Thus it could enjoin not only radio broadcasts but also representations by Whiteman that he alone could license broadcasts. Both sides have appealed from this decision not only on its rules of law but on its contract interpretation.

6. The legal issues of the *Waring* case have been extensively discussed and the result approved. Pforzheimer, *Copyright Protection for the Performing Artist* (1938) COPYRIGHT LAW SYMPOSIUM 9; Bass, *Interpretative Rights of Performing Artists* (1937) 42 DICK. L. REV. 57; Littauer, *Present Legal Status of Artists, Recorders, and Broadcasters in America* (1938) 3 GEISTIGES EIGENTUM 217; Notes (1938) 18 B. U. L. REV. 441, (1938) 38 COL. L. REV. 181, (1937) 51 HARV. L. REV. 171, (1937) 86 U. OF PA. L. REV. 217, (1938) 24 VA. L. REV. 333, (1938) 23 WASH. U. L. Q. 283. *Cf.* (1938) 22 MINN. L. REV. 559.

7. The scope of this Note will be limited to radio's unlicensed broadcasts and will not deal with the use of records for other commercial purposes.

8. Waring v. Dunlea, 26 F. Supp. 338 (E. D. N. C. 1939) (suit to enjoin the playing of electrical transcriptions which had never been sold to the public); RCA v. Whiteman, 28 F. Supp. 787 (S. D. N. Y. 1939); Noble v. 160 Commonwealth Ave., 19 F. Supp. 671 (D. Mass. 1937) (performer denied injunction against night club broadcasts because his rights, if any, had been assigned to recorder); Waring v. WDAS, 327 Pa. 433, 194 Atl. 631 (1937); Crumit v. Marcus Loew, 162 Misc. 225, 293 N. Y.

to diminish unlicensed broadcasts in general.[9] Further, if the judicial remedy were adequate,[10] the additional task remains of establishing the *Waring-Whiteman* doctrine in some forty-six jurisdictions, where it has not as yet been accepted.[11]

Even in the rare circumstance where an injunction is feasible, hostile legislation now threatens to destroy this small protection for performers and recorders. Shortly after the federal district court in North Carolina enjoined a local station from broadcasting electrical transcriptions without permission,[12] "all common law rights in records" were abolished by the state legislature.[13] Similar bills were passed in South Carolina[14] and proposed in Florida.[15] This legislation appears to be inspired solely by the self-interest of one class, the commercial users of records.[16] The statutes, scarcely indicative of a general public policy, may well be held unconstitutional under the due process and abrogation of contract clauses.[17] Yet wholly aside from the question of their validity, the expense of litigation challenging them is so great[18] as to hamper seriously any attack, particularly so long as the common law protection for interests in records is as ineffectual as at present.

A further obstacle to a realization of the benefits which should logically accrue to performers and recorders from the *Waring* and *Whiteman* decisions may be offered by the opposition of groups in related fields.[19] After the

Supp. 63 (Sup. Ct. 1936) (performer denied recovery because his rights, if any, were assigned to recorder).

9. Communication to YALE LAW JOURNAL from counsel for RCA, Oct. 10, 1939.

10. A logical implication of the injunction granted in the *Waring* and *Whiteman* cases might afford too complete a remedy; for the broadcasting of all records bearing a restrictive notice might be enjoined *in perpetuo*, thus resulting in an over-severe judicial monopoly. See note 61 *infra*.

11. Only the *Waring* (Pa.) and the *Whiteman* (N.Y.) cases explicitly rule on rights in records. For the other decisions not expressly raising these issues, *see* note 8 *supra*.

12. Waring v. Dunlea, 26 F. Supp. 338 (E. D. N. C. 1939).

13. N. C. CODE ANN. (Mitchie, 1939) § 5126(s).

14. S. C. Acts 1939, No. 28.

15. Florida, Sen. Bill No. 637 (1939).

16. Recorders plausibly assert that this legislation was the work of "organized lobbies." Memorandum for Decca Records, Inc., before The Committee for The Study of Copyright, p. 12. The authorship of bills directed against composers fees has been convincingly traced by ASCAP to radio and other users of records. Communication to YALE LAW JOURNAL from counsel for ASCAP, Sept. 29, 1939. *See* Comment (1939) 33 ILL. L. REV. 548, 549, 553.

17. Prohibitory Florida statutes directed against ASCAP have been held invalid. *See* note 40 *infra*.

18. *See* note 42 *infra*.

19. The American Federation of Musicians, whose primary objective is to increase employment for the rank and file musicians whom it represents, has recently adopted a rule providing that none of its members may assign to any recorder their "broadcasting rights" without the express consent of the Federation. Communication to YALE LAW JOURNAL from counsel for National Association of Broadcasters, Oct. 18, 1939. A powerful union, A.F.M. probably can withhold this consent from recorders so that, under the *Whiteman* doctrine, they will not have the sole right to license even after they

Whiteman decision, RCA, one of the largest recorders, proposed a plan for the licensing of broadcasters who use its records.[20] Radio has ignored this scheme,[21] and its success as a revenue device for recorders is threatened by the demands of music publishers for a large share of the putative income.[22] Publishers appear sufficiently powerful to enforce this "request," for they possess, by assignment from composers, the mechanical recording privileges which are granted by statute to copyright owners of musical compositions.[23] If record popularity, as seems likely, credits more the fashionable orchestra than the popular tune,[24] the band's share in broadcasting revenue should be larger than the publisher's. Instead, the lion's share seems destined for the publishers,[25] simply because, being the sole copyright owner,[26] they are the strongest bargainer in this triangular dispute with recorders and performers. Determination of the profit-distribution between orchestra, recorders and publishers by ill-balanced bargaining power would mean that judicial recognition of rights in records, if it should accomplish anything at all, would enrich the publishers at the expense of those primarily intended to be its beneficiaries.

Thus practical difficulties make protection for performers and recorders through judicial decision alone of little avail. Assuming effective protection to be desirable, it is apparently obtainable only through legislation. Uniform

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have acquired the performer's rights. That musicians less accomplished than conductors or soloists also have an intellectual property right in renditions appears established by the language of the *Waring* decision. See Waring v. WDAS, 327 Pa. 433, 442, 194 Atl. 631, 635 (1937).

20. Communication to YALE LAW JOURNAL from counsel for RCA, Sept. 26, 1939. Decca Records, Inc., has followed suit, but Columbia is reputed to have offered their privileges free to at least one station in an effort to underbid its rivals for radio advertising. Another recorder intends to prohibit broadcasting altogether. Communication to YALE LAW JOURNAL from counsel for National Association of Broadcasters, Dec. 5, 1939.

21. Communication to YALE LAW JOURNAL from counsel for RCA, Oct. 10, 1939. In the metropolitan vicinity something in the nature of a truce appears to exist by which some stations have ceased broadcasting restricted records until the recorders' policy becomes more clear.

In 1938 RCA had tried to license broadcasts, but without success.

22. Communication to YALE LAW JOURNAL from counsel for National Association of Broadcasters, Oct. 18, 1939.

23. 35 STAT. 1075, 1076 (1909), 17 U. S. C. § 1 (1934).

24. The popularity of a Goodman, Dorsey or Lombardo does more to sell records than preferences for the composition played. In classical music, of course, the composer is far more significant, yet Toscanini and Koussevitsky are nonetheless favorites.

25. At first, publishers demanded 50% of the gross license revenues. This demand was modified after recorders offered to split the fees three ways among artists, recorders, and publishers. Communications to YALE LAW JOURNAL from counsel for RCA. Any payment at all to publishers owning recording rights is to the extent that it flows back to the composers a double payment for them, inasmuch as they are already paid through ASCAP for broadcasts of their music, whether "live" or "canned."

26. Although the arranger may copyright his work, he must obtain the consent of the owner of the composer's copyright. 35 STAT. 1077 (1909), 17 U. S. C. § 6 (1934). Ordinarily, gifted arrangers do not bother to copyright their work, as it is more profitable to write for one big-name band without publishing for the general market.

state laws granting and providing for the enforcement of property rights in records are, of course, possible; but the multiple difficulties of enactment, and the probable local variations that would develop make such a scheme impractical.[27] Radio's disregard of geographical and jurisdictional boundaries points rather to the necessity of federal legislation; and the federal copyright power offers a desirable solution. A copyright in records, with provisions for statutory damages[28] similar to those found so effective in the composer's copyright,[29] appears the most effective method of checking unlicensed broadcasts. And only through exercise of the exclusive federal copyright power could partisan state laws abolishing property rights in records be superseded.[30]

But the drafting and enactment of a copyright in records will be difficult. Even if such a bill could survive the opposition of radio and composers to any copyright at all,[31] a complex problem would arise in determining which of the chief claimants should own the copyright. Recorders and "performers," who are for this purpose synonymous with orchestra leaders, have each laid claim to the copyright, and bills on behalf of the latter have already been introduced in Congress.[32] Their claims have been considered necessarily exclusive — not because the validity of either cause is questioned, but because enforcement would be overcomplicated if each party owned a separate copyright.[33] Both a copyright for performers and one for recorders has been considered recently by the Shotwell Committee for the Study of Copyright, which is drafting a privately proposed revision of the federal copyright

27. *See* Bass, *op. cit. supra* note 6, at 68.

28. The Daly Bill, H. R. 5275, 75th Cong., 1st Sess. (1937), proposing a copyright in records, set the minimum at $500. The bill was never reported back from committee.

29. 35 STAT. 1081 (1909), 17 U. S. C. § 25(b) (1934). The provision for minimum damages ($250) has been so effective as a deterrent that only $8,800 has been collected by ASCAP for infringements in twenty-seven years. *Hearings before the Committee on Patents for Revision of the Copyright Law*, H. R., 74th Cong., 2d Sess. (1936) 201, 202. *See* Comment (1938) 47 YALE L. J. 433, 442.

30. Both the North and South Carolina Acts provided that they should not conflict with the federal copyright power. N. C. CODE ANN. (Mitchie, 1939) § 5126(s); S. C. Acts 1939, No. 28, § 2.

31. Broadcasters are naturally opposed to any addition to the $3,500,000 annual fees paid to ASCAP. N. Y. Times, Sept. 16, 1939, p. 19, col. 1. ASCAP is militantly hostile to any increase in the strength of a rival for this radio revenue. It has also been asserted that a copyright in records would unfairly deprive composers of their exclusive rights Memorandum of Musical Publishers Protective Association, submitted to the Committee for the Study of Copyright, p. 5. This viewpoint is myopic in its failure to concede that, particularly in America, it is the performers who make music a commercial success. Even in Europe an identical argument by French and Italian composers' associations has been questioned. Ostertag, *Nouvelles Propositions pour la Conference de Bruxelles* (1939) 52 DROIT D'AUTEUR 62, 65.

32. H. R. 10632, 74th Cong., 2d Sess. (1936); H. R. 5275, 75th Cong., 1st Sess. (1937); H. R. 6160, 76th Cong., 1st Sess. (1939). These bills were inspired by the National Association of Performing Artists (NAPA) of which Fred Waring and Paul Whiteman are directors. None have met with any success.

33. Littauer, *op. cit. supra* note 6, *passim;* Pforzheimer, *op. cit. supra* note 6, *passim.*

law.[34] Neither claim has as yet met with any success, owing to the dissension among the contending groups,[35] but continued lack of protection for performers and recorders may soon force a reconciliation of differences and a choice between the two claims.

In determining the proper owner of the copyright, the performer's claim, at first glance, appears superior to the recorder's. Insofar as copyrights are designed to reward talent, performers are the deserving artists rather than recorders. But the source of artistic creation bears little relation to attainment of the maximum protection ultimately desirable for both claimants. Effective enforcement in the interests of both performers and recorders should instead be the determinative factor in choosing the copyright owner.

If this be the criterion taken for selection, then definite administrative drawbacks to a performer's copyright immediately appear. An obvious practical defect in a copyright for artists is the formidable difficulty in determining who among the several performers should receive the copyright.[36] Certainly, conductor, soloist and orchestra members all contribute to the performance. Surprisingly enough, bills favoring a copyright for performers overlooked this dilemma until recently;[37] yet a solution is possible. A compulsory assignment of each contributing artist's rights to one representative would facilitate selection.[38] This, however, would not eliminate an even more serious weakness in the performer's copyright; for, if users of records should be required to obtain licenses from each performer owning a copyright, a chaotic jumble unsatisfactory both to performers and radio would result. In contrast, a recorder-copyright can raise no initial dispute as to copyright ownership, and further, since there are only four American recorders, licensees could negotiate much more conveniently. Moreover, it is doubtful whether numerous orchestras, each holding a copyright in its renditions, could detect and prosecute infringements with a fraction of the efficiency possible to a few recorders. Of course, an association of performers might

34. The Committee for the Study of Copyright is part of the American National Committee for International Intellectual Cooperation of which Prof. James Shotwell is chairman. The Shotwell Bill is scheduled to come up before Congress in March, 1940. 84 Cong. Rec., Aug. 1, 1939, at 14799.

35. NAPA, the American Federation of Musicians and recorders each fought for ownership of a copyright in records while ASCAP and radio objected to it altogether. Recording publishers were willing to support a recorder's copyright only in exchange for the termination of the present statutory license provision which compels them to license, after the initial licensing release, any recorder who wanted their music. Neither the Committee itself nor the various groups were able to agree on the exact reason why a copyright in records was omitted from the Shotwell draft. Communications to YALE LAW JOURNAL from counsel for RCA, counsel for National Association of Broadcasters, and from the Executive Secretary of the Shotwell Committee. Such bitter conflicts of economic interests have habitually blocked attempts to amend the copyright laws. Legis. (1938) 51 HARV. L. REV. 906; *See* (1937) 8 AIR L. REV. 213, 216, 220.

36. Littauer, *op. cit. supra* note 6, at 232; Pforzheimer, *op. cit. supra* note 6 at 31.

37. *See* note 38 *infra.*

38. The McGranery Bill, H. R. 6160, 76th Cong., 1st Sess. (1939) gives the copyright to the orchestra conductor. The 1936 Austrian Act carries a similar provision. LISSBAUER, AUSTRIAN AUTHORSHIP RIGHT LAWS (Racz's transl. 1937) 32. The Austrian Act is to become the law of Germany. Ostertag, *op. cit. supra* note 31, at 62.

conceivably solicit the rights of individual copyright holders and eventually become sole agent. But whatever administrative superiority a possible pooling of copyrights might achieve at the start is not certain to be maintained in the future. A similar copyright pool for composers, the American Society of Authors, Composers, and Publishers, has been seriously checked in certain states under recent statutes,[39] and it is probable that similar acts would be passed which would greatly impair the effectiveness of any performer's pool. Although one of the more stringent anti-ASCAP acts has been held invalid by a lower court,[40] milder ones may well be sustained if the interference with the exclusive federal copyright power is considered too indirect to be unconstitutional.[41] At any rate the considerable expense of fighting this legislation has somewhat hampered ASCAP's effectiveness.[42] The recorder's copyright is not so vulnerable, for any attack upon the owner's own exercise of the copyright privileges would be unmistakably a direct interference with the federal power which would be far less likely to be sustained.[43] And not only is proprietorship by recorders demonstrably more efficacious than by performers, but also the consequent notion or a copyright in the marketing entrepreneur is not without precedent. In the film industry, which is similar to the recording industry in many aspects, a copyright in producer rather than in actor has developed as the practical solution.[44] Experience with a

39. Alaska Laws 1939, c. 13; FLA. COMP. GEN. LAWS ANN. (Skillman, Supp. 1938) § 7954, Fla. Laws 1939, c. 19653; Kansas Laws 1939, c. 306; Mont. Laws 1937, c. 90, and Laws 1939, c. 123; NEBR. COMP. STAT. (Supp. 1939) § 59-1201; N. D. Laws 1939, c. 115; TENN. CODE ANN. (Williams, Supp. 1939) § 6761; WASH. REV. STAT. (Remington, Supp. 1939) § 3802.

40. Gibbs v. Buck, U. S. Dist. Ct., Fla., Oct. 21, 1939. Suits are pending in the other states. Communication to YALE LAW JOURNAL from counsel for ASCAP, Sept. 29, 1939. The grounds of the Florida decision probably were lack of due process, abrogation of contract, and invasion of the exclusive federal copyright power. *See* Gibbs v. Buck, 307 U. S. 66, 69 (1939).

41. Perhaps the mildest act is the present Montana law which does not outlaw ASCAP, nor prohibit blanket licensing as other acts have done, but does require that composers file copious data with the Secretary of State and prohibits composers from charging for collateral programs on which their music is not actually played. Mont. Laws 1939, c. 123. Though a great hindrance to ASCAP, this type of law may be sustained if courts think in terms of monopoly, or police power, instead of copyright. *See* Paramount Pictures v. Langner, 23 F. Supp. 890, 895 (1938) (statute prohibiting copyright owner from controlling the exhibitors of its work held no invasion of copyright power); *cf.* Comment (1939) 33 ILL. L. REV. 548, 555. Indeed Justice Black has indicated that even a complete prohibition of copyright pools would be constitutional, because they are a monopoly. Gibbs v. Buck, 307 U. S. 66, 81-84 (1939).

42. Communication to YALE LAW JOURNAL from counsel for ASCAP, Sept. 29, 1939.

43. Of course, a direct but mild interference with the copyright owner might be sustained. *See* Allen v. Riley, 203 U. S. 347 (1906) (patents) and cases there cited. But a pool of copyright owners is susceptible to treatment as an illegal combination. *See* Mr. Justice Black, dissenting in Gibbs v. Buck, 307 U. S. 66, 81-84 (1939); Interstate Circuit v. United States, 306 U. S. 208, 227 (1939) (successful prosecution under the Anti-Trust Act).

44. 37 STAT. 488 (1912), 17 U. S. C. § 5(m)(n) (1934).

recorder's copyright in England[45] and several other countries[46] has proved its feasibility.

In America, however, the recorder's lack of artistic contribution[47] might offer a plausible reason for awarding the copyright to performers, for it might render unconstitutional a copyright which was based solely upon the recording process. Of course, any copyright in records will be unconstitutional, whoever the owner, if a record cannot be considered as a "writing" within the constitutional provision,[48] but previous judicial inclusion within this privileged classification of the photograph[49] and moving picture film[50] should preclude any constitutional objections on this score. And while "talent" was once a significant prerequisite for copyright recognition,[51] the requirement has been construed so broadly as to be immaterial today.[52] Thus the recorder's contribution would seem to be copyrightable as well as the artist's. In any case, the customary assignment of the performer's "talent" to the recorder would provide an unassailable basis for a recorder's copyright,[53] so constitutional issues should be of little weight in determining either the availability of a copyright in records or the choice of its owner.

A recorder's copyright, however, has distinct limitations, even if it does offer a valid and effective method of protecting interests in records. It cannot

45. Copyright Act, 1911, 1 & 2 Geo. V, c. 46, § 19(1). This statute has been reenacted throughout British Empire. Koepfle, *Copyright Protection throughout the World; Part Two: The British Empire*, Ind. Prop. Bull., U. S. Dep't of Commerce, June 20, 1936.

46. Bulgaria, Denmark, Estonia, Germany, Hungary, Jugoslavia, Latvia, Lithuania, Netherlands, Japan, Switzerland, and Finland, and the erstwhile countries of Austria, Czechoslovakia and Poland have been said to have some form of recorder's copyright. *Cf. Hearings, op. cit. supra* note 28, at 1364; Littauer, *op. cit. supra* note 6, at 236; and memorandum of Decca Records, Inc., submitted to the Committee for the Study of Copyright, p. 6. The English text of every statute is set out without annotation by Koepfle in *Copyright Protection throughout the World*, Ind. Prop. Bull., U. S. Dep't of Commerce, May 20, June 20, Aug. 10, Sept. 21, Oct. 27, 1936, and Jan. 10 and 15, 1937. Decisions, however, have denied that a recorders' copyright was intended under some of these statutes: *See* Baum, *Die Urteile in den Prozessen zwischen Rundfunk und Schallplattenindustrie und ihre Kritik*, (1938) 3 GEISTIGES EIGENTUM 239; (1939) 4 COPYRIGHT 372.

47. This conclusion of the *Whiteman* decision might be questioned. *See* note 4 *supra*.

48. U. S. CONST. ART. III, § 8. The basis of this contention is White-Smith Music Publishing Co. v. Apollo Co., 209 U. S. 1 (1908) which held that a piano roll was not a "copy" of sheet music, but the decision concerned the intent of Congress to include piano rolls within the meaning of "copy" in the 1891 Act, and no issue of constitutionality was raised.

49. Burrow-Giles Lithographic Co. v. Sarony, 111 U. S. 53 (1884).

50. Metro-Goldwyn-Mayer Distributing Corp. v. Bijou Theatre, 3 F. Supp. 66 (D. Mass. 1933).

51. *See* Umbreit, *A Consideration of Copyright*, (1939) 87 U. OF PA. L. REV. 932.

52. *Ibid.* Circus posters, telephone directories, and citators have been held copyrightable. Bleistein v. Donaldson Lithographing Co., 188 U. S. 239 (1903); Leon v. Pacific Tel. & Tel. Co., 91 F. (2d) 484, (C. C. A. 9th, 1937); Shepard v. Taylor, 193 F. 991 (C. C. A. 2d, 1912).

53. To protect recorders in all cases, this assignment could be made compulsory.

by itself guarantee an equitable distribution of radio proceeds to performers, which the artists are probably unable to contract for themselves,[54] nor does it offer any protection at all against appropriation of the "live," or unrecorded, renditions.[55] Further, an unqualified copyright makes no provision for a limitation in the amount of license fees, which might seem consonant with public interest in the wide dissemination of music afforded by broadcasts. To avoid these weaknesses in a recorder's copyright, supplemental provisions should be enacted. Extreme protection for performers might possibly be accomplished by giving them an additional, separate copyright, as is provided in Germany.[56] But the existence of two copyright proprietors would greatly complicate the licensing of records,[57] a factor recognized by a proposed revision of the German law.[58] It would be simpler to prevent appropriation of live renditions by following England's example of making any recording without the performer's permission a criminal offense.[59] And to guarantee to performers an equitable share in license revenues, Congress should require that a certain minimum proportion of the fees be paid to them.[60]

In addition to these provisions limiting recorders' privileges in favor of performers, some general restriction upon the copyright itself is desirable in the interests of the public. Although the enactment of a copyright might not diminish severely the broadcasts of records, since broadcasts of moderate frequency advertise rather than overpopularize the recorder's product, nevertheless provision for maximum license fees and a short term[61] for the copyright may be desirable in order to insure to the public the continued benefit of frequent recorded broadcasts. Ancillary to maximum fees, a compulsory license provision similar to that applied to the composer's copyright[62] would be a highly commendable method of preventing an undue restriction of

54. Illustrative of the weak position of performers is the fact that in less than a dozen cases have they been able to reserve their broadcasting rights. Memorandum of The National Association of Broadcasters, released to its members after the *Whiteman* decision, p. 3.

55. Toscanini's first broadcasts over NBC were made into records directly from the receiving set.

56. Germany: Law of May 22, 1910, 1910 REICHSGESETZBLATT 793, art. 1, par. 2.

57. Littauer, *op. cit. supra* note 6, at 235.

58. Ostertag, *op. cit. supra* note 31, at 64.

59. 15 & 16 Geo. V. c. 46, § 1(a) (1925).

60. Such a pro rata provision would be less cumbersome than giving the performer a right to an equitable share in the proceeds, to be determined by the court, as has been done in Latin-American countries. The Argentine: Law of Sept. 23, 1933, LAWS OF ARGENTINA (De Marval. transl. 1933) 1233, art. 56; Uruguay: Law of Dec. 17, 1937, (1938) 51 DROIT D'AUTEUR 55, art. 36. *Cf.* NUEVO CODIGO CIVIL, art. 1, 191 (Mexico, 1936).

61. The term should be long enough to protect the performer during his commercial "lifetime" from injury through the playing of his earlier and perhaps inferior recordings. Through a copyright for a specific term, the undesirable monopoly of an *in perpetuo* injunction would be avoided, for under traditional copyright law, publication is an abandonment of common-law rights, and the artist's protection is based solely on the statute. *See* Universal Film v. Copperman, 218 Fed. 577 (C. C. A. 2d, 1914); Wagner v. Conried, 125 Fed. 798 (C. C. S. D. N. Y. 1903).

62. 35 STAT. 1075, 1076 (1909), 17 U. S. C. § 1 (1934).

broadcasts.[63] Under such a clause any station might obtain a license at the statutory fee after the recorder had initially licensed the record or repertoire of records to a rival station.

If the desirability of protection for performers and recorders be accepted, it would seem apparent that a recorder's copyright, buttressed by the suggested ancillary legislation, would give most effective expression to the safeguards which the *Waring* and *Whiteman* cases sought, but failed, to attain.

JURISDICTION UNDER SECTION 77 OVER PLENARY SUITS AGAINST NON-RESIDENTS*

PRIOR to the enactment in 1933 of Section 77 of the Bankruptcy Act,[1] the usual method of reorganizing insolvent railroads was through equity receivership proceedings in the federal courts.[2] As part of these proceedings, the court, if it had jurisdiction over the parties, entertained plenary suits brought by the receiver for such purposes as recovering claims of the railroad.[3] Jurisdiction over the subject matter was not predicated on diversity of citizenship or fulfillment of jurisdictional amount, but was regarded as ancillary to the court's jurisdiction in the main proceeding.[4] Equity receivership courts occupied a unique position in this respect, since bankruptcy courts in general had no such jurisdiction over plenary actions.[5] With the exception of consent suits and those brought under Sections 60, 67 and 70, Section 23 of the Bankruptcy Act[6] limited the jurisdiction of the bankruptcy court, in actions brought by the trustee, to courts where the bankrupt might have brought them if bankruptcy proceedings had not been instituted.[7]

63. Such a provision would be particularly desirable since two of the recorders are subsidiaries of the two largest radio chains and consequently might restrict broadcasting to their own systems.

* Thompson v. Terminal Shares, Inc., *et al.*, 104 F. (2d) 1 (C. C. A. 8th, 1939), *cert. denied*, 7 U. S. L. WEEK 356 (U. S. Sup. Ct., Oct. 10, 1939).

1. 47 STAT. 1474 (1933), 49 STAT. 911 (1935), 49 STAT. 1969 (1936), 11 U. S. C. § 205 (Supp. 1938).

2. Friendly, *Some Comments on the Corporate Reorganizations Act* (1934) 48 HARV. L. REV. 39.

3. White v. Ewing, 159 U. S. 36 (1895); Barfield v. Zenith Tire & Rubber Co., 9 F. (2d) 204 (N. D. Ohio 1924), *aff'd, sub. nom.* Kirby v. Wilson, 27 F. (2d) 327 (C. C. A. 6th, 1928).

4. *See* Gerdes, *Jurisdiction of the Court in Proceedings Under Section 77B* (1935) 4 BROOKLYN L. REV. 237, 272, and cases there cited.

5. Bardes v. Hawarden Bank, 178 U. S. 524 (1900); Jaquith v. Rowley, 188 U. S. 620 (1903); Kelley v. Gill, 245 U. S. 116 (1917).

6. 44 STAT. 664 (1926), 11 U. S. C. § 46 (1934).

7. "A United States District Court has jurisdiction of (a) plenary actions brought pursuant to Sections 60, 67 and 70, regardless of the defendant's *consent*, (b) of *any* plenary suit by the receiver or trustee to which the defendant *consents*, and (c) such other plenary actions not falling within (a) and (b) *supra* as could have been maintained in the federal courts by the debtor had not proceedings under this act ensued." MOORE'S BANKRUPTCY MANUAL (1939) ¶ 23.01.

The method of reorganization provided by Section 77 is in many respects a codification of the former equity receivership method,[8] but the powers and jurisdiction of the federal courts acting in reorganization proceedings under the section are defined in terms of the jurisdiction and powers of both equity receivership and bankruptcy courts. Thus subdivision (l) of Section 77 confers upon the reorganization court the powers and jurisdiction of an ordinary bankruptcy court. Another provision declares that the reorganization court shall "have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose."[9] These provisions give rise to the question whether Congress, in expressly conferring upon the reorganization court *powers* equal to those of an equity receivership court, impliedly granted the *jurisdiction* of such a court. The next sentence of subdivision (a) relates to the court's jurisdiction over persons: "Process of the court shall extend to and be valid when served in any judicial district." This provision should apparently enable the railroad reorganization court to exercise a much wider in personam jurisdiction than its predecessors, since neither the federal equity receivership court nor the bankruptcy court could issue valid process outside its own district.[10]

A recent case[11] presents one of the first judicial interpretations of these jurisdictional provisions of Section 77.[12] The trustee of the Missouri Pacific

8. *See* FINLETTER, THE LAW OF BANKRUPTCY REORGANIZATION (1939) 18, 19.

9. 49 STAT. 911 (1935), 11 U. S. C. § 205 a (Supp. 1938).

10. Barfield v. Zenith Tire & Rubber Co., 9 F. (2d) 204 (N. D. Ohio 1924); Bovay v. Byllesby & Co., 88 F. (2d) 990 (C. C. A. 5th, 1937). Rule 4 (f) of the Federal Rules of Civil Procedure provides that the process of a district court may be served anywhere within the state in which the court is situated. Section 56 of the Judicial Code provides an exception where the process of a federal court may run throughout the circuit. 36 STAT. 1102 (1911), 28 U. S. C. § 117 (1934). For *in rem* actions, *see* 36 STAT. 1102 (1911), 28 U. S. C. § 118 (1934).

11. Thompson v. Terminal Shares, Inc., *et al.*, 104 F. (2d) 1 (C. C. A. 8th, 1939), *cert. denied*, 7 U. S. L. WEEK 356 (U. S. Sup. Ct., Oct. 10, 1939).

12. Section 77 as amended by the Act of Aug. 27, 1935, 49 STAT. 911 (1935), 11 U. S. C. § 205 (Supp. 1938), conferred upon the railroad reorganization court exactly the same subject matter jurisdiction over entities dealt with in Section 77 as that possessed by a court acting under § 77B. 48 STAT. 912, 11 U. S. C. § 207 (1934). Therefore cases arising under § 77B are applicable on the question of the subject matter jurisdiction of the court acting under § 77. However, none of the cases cited in the principal case are binding authority. *In re* Prima Co., 98 F. (2d) 952, 958 (C. C. A. 7th, 1938), involved a summary suit, but it contains a dictum that § 23 of the Bankruptcy Act applies to a reorganization court so that it cannot entertain a plenary suit. Matter of United Sportwear Co., 28 Am. B. R. (N. S.) 456, 457 (D. Mass. 1935) is a similar case. A contrary result was reached in Thomas v. Winslow, 11 F. Supp. 839, 841 (W. D. N. Y. 1935), where a court acting under § 77B entertained a plenary suit apparently on the erroneous ground that an unliquidated claim for money alleged to have been wrongfully taken from the debtor is "property" of the debtor over which the reorganization court has exclusive jurisdiction. The court expressed the belief that § 23 did not apply to a court acting under § 77B. *In re* Patten Paper Co., 86 F. (2d) 761 (C. C. A. 7th,

Railroad filed an ancillary bill in a federal district court for the eastern district of Missouri as part of the reorganization proceedings then pending in that court. Plaintiff prayed for an accounting by the defendants and the recovery of $3,200,000 advanced to the defendant Terminal Shares, Inc., by Missouri Pacific as part payment under four allegedly invalid contracts contemplating the purchase of certain stocks and notes of various Missouri corporations. The plaintiffs furthermore prayed for the imposition and foreclosure of an equitable lien for that sum on the contract's subject matter, which consisted of shares of stock of corporations domiciled in the western judicial district of Missouri. A special appearance was filed by the defendants who moved that an order authorizing extra-territorial service be vacated and that the process served upon them outside the district be quashed. The granting of the motion by the district court[13] was affirmed by the Circuit Court of Appeals for the Eighth Circuit which held: (1) that the court had no jurisdiction over the subject matter of this plenary suit because it was bound by the limitations of Section 23 of the Bankruptcy Act; (2) that the court lacked jurisdiction over the persons of the defendants since they were served with process outside the district. Either basis of the decision seems open to question.[14]

With regard to the first ground of the decision, it is clear that, although an ordinary bankruptcy court could not entertain this plenary action without the defendant's consent, a federal equity receivership court would have jurisdiction over the subject matter of the action, if the defendants were within the territorial limits of the court's process.[15] If Congress had expressly freed reorganization courts acting under Section 77 from the limitations of Section 23, as it did reorganization courts acting under Chapter X of the Bankruptcy Act,[16] there would be no question of jurisdiction over the subject matter of the suit. Instead, Congress used the vague terminology of jurisdiction and powers. The omission of an express exemption, however, should not have resulted in the interpretation reached by the court in the instant case, since achievement of the ends of Section 77[17] requires that the reorganization court should have jurisdiction over plenary actions. This requirement is dictated by the very nature of reorganization procedure. Before a plan of reorganization can be adopted, the assets of the debtor must be

1936), and First Nat. Bank v. Conway Road Estates Co., 94 F. (2d) 736 (C. C. A. 8th, 1938), merely hold that a reorganization court cannot decide adverse claims in a *summary* proceeding. United States v. Tacoma Oriental S. S. Co., 86 F. (2d) 363 (C. C. A. 9th, 1936), and Bovay v. Byllesby & Co., 88 F. (2d) 990 (C. C. A. 5th, 1937), hold only that the court did not have jurisdiction of the persons of the defendants.

13. *In re* Missouri P. R. R., Thompson v. Terminal Shares, Inc., *et al.*, 24 F. Supp. 724 (E. D. Mo. 1938).

14. On facts similar to those in the instant case, the Second Circuit Court of Appeals has apparently recently decided *contra*. Litigation between New York, N. H. & H. R. R. and Boston & P. R. R., reported in N. Y. Times, Dec. 19, 1939, p. 39, col. 5-6.

15. *See* footnote 3 *supra*.

16. 52 STAT. 883, 11 U. S. C. § 502 (Supp. 1938).

17. *See Hearings before Committee on the Judiciary on H. R. 6249*, 74th Cong., 1st Sess. (1935) 13-23; Sunderland, *Railroad Reorganizations* (1936) 2 CORP. REORG. 324-340.

ascertained with a fair degree of accuracy. In the principal case, the computation of assets required resort to a plenary suit. The jurisdiction over these actions given to receivership courts does not seem to have unduly prejudiced the rights of the parties or given rise to inordinate hardships. Certainly, Section 77 should not needlessly be interpreted so as to make reorganization proceedings less efficient than they were under the old, cumbersome equity receivership method which the section was designed to replace. And in view of the similar purposes of Chapter X and Section 77, the jurisdiction of a railroad reorganization court should be at least as broad as that of an ordinary corporate reorganization court.

The phraseology of subdivision (l) of Section 77 did not compel the court to ignore the weight of policy by declaring that there was no jurisdiction over the subject matter. The grant of the *powers* of an equity receivership court should have been interpreted to include a grant of the *jurisdiction* of such courts,[18] since it would appear that one of the powers of an equity receivership court was that of entertaining plenary suits.[19] Since Congress chose to confer upon the reorganization court the powers of both bankruptcy and equity receivership courts, it would have been more reasonable to hold that the new court was burdened only by the limitations common to both.[20] The very inclusion within the jurisdictional provisions of the phrase conferring upon the reorganization court the powers of an equity receivership court gives rise to the hypothesis that the grant has some bearing upon the court's jurisdiction.[21] If the phrase has any relevancy as a jurisdictional provision, its effect must be that of freeing the reorganization court from the limitations of Section 23 of the Bankruptcy Act, since the court already possessed all other jurisdiction of an equity receivership court by virtue of its possession of the jurisdiction of a bankruptcy court.[22]

The second ground of the decision was that the court had no jurisdiction over the persons of the defendants because the process served upon them outside the district was invalid. This holding seems contrary to the mandate of Congress that: "Process of the court shall extend to and be valid when served in any judicial district."[23] The decision is apparently the first sug-

18. *See* Gerdes, *supra* note 4, at 272, 278; *Developments in the Law—Reorganization Under Section 77B of the Bankruptcy Act* (1936) 49 HARV. L. REV. 1111, 1146; Comment (1936) 49 HARV. L. REV. 797, 803, 804. *But see* FINLETTER, PRINCIPLES OF CORPORATE REORGANIZATION (1937) 186–187; FINLETTER, THE LAW OF BANKRUPTCY REORGANIZATION (1939) 181–184.

19. *See* footnote 3 *supra.*

20. *See* Gerdes, *supra* note 4, at 272.

21. In more than one instance, courts seem to have interpreted the provision as conferring the jurisdiction of an equity receivership court. In *In re* Prima Co., 98 F. (2d) 952, 958 (C. C. A. 7th, 1938), it is said that the reorganization court has been granted "the jurisdiction which a federal court would have, had it appointed an equity receiver . . ."; *see* United States *et al.* v. Tacoma Oriental S. S. Co., 86 F. (2d) 363, 369 (C. C. A. 9th, 1936).

22. *See* Gerdes, *supra* note 4, at 271.

23. 49 STAT. 911 (1935); 11 U. S. C. § 205 (a) (Supp. 1938).

gestion that the process provision should be so narrowly interpreted.[24] The two cases[25] which the court cites as authority for its holding are no authority at all, since they arose under Section 77B, which contained no provision authorizing extra-territorial service of process. One of the opinions even implied[26] that the court would have had jurisdiction if the proceeding had been under Section 77. The holding in the principal case is especially surprising in view of several cases[27] which have given a very broad scope to the process power of reorganization courts. In the *Rock Island* case,[28] the Supreme Court upheld an injunction issued by a railroad reorganization court restraining non-resident holders of collateral pledged by the debtor from disposing of the collateral. This decision was rendered before the process provision was added to Section 77,[29] but the court found, "as a necessary consequence" of its exclusive jurisdiction over the debtor's equity in the pledged collateral, the power to issue its process outside the district to preserve and safeguard its exclusive jurisdiction.

In the principal case the court expressed the belief that the provision empowering the reorganization court to issue valid extra-territorial process was intended merely to make certain that the court had the means of effectively exercising its exclusive jurisdiction over the property of the debtor wherever located and that it was no more than a statutory confirmation of the *Rock Island* decision. But why should Congress frame an amendment to empower the court to serve valid process outside the district for the limited purpose of protecting the property of the debtor, when the court already had the power under the *Rock Island* decision? If Congress intended such a narrow interpretation, why did it provide in broad terms that process of the court shall be valid when served in any judicial district? Section 77 is obviously one of those instances where Congress has exercised its well-recognized power to provide that process of a federal court shall extend throughout the country.[30] This clearly expressed intent should be effectuated.

24. Discussions have taken it for granted that the provision enabled the court to serve its process extra-territorially in suits such as the present. FINLETTER, *op. cit. supra* note 8, at 175; *Developments in the Law—Reorganization Under Section 77B of the Bankruptcy Act* (1936) 49 HARV. L. REV. 1111, 1143.

25. United States v. Tacoma Oriental S. S. Co., 86 F. (2d) 363 (C. C. A. 9th, 1936); Bovay v. Byllesby & Co., 88 F. (2d) 990 (C. C. A. 5th, 1937).

26. *See* United States v. Tacoma Oriental S. S. Co., 86 F. (2d) 363, 369 (C. C. A. 9th, 1936).

27. Continental Ill. Nat. Bank & Trust Co. v. Chicago, R. I. & P. R. R., 294 U. S. 648 (1935); *In re* Greyling Realty Corp., 74 F. (2d) 734 (C. C. A. 2d, 1935); Thomas v. Winslow, 11 F. Supp. 839 (W. D. N. Y. 1935); *In re* Norfolk Weavers, Inc., 12 F. Supp. 495 (D. Del. 1935).

28. Continental Ill. Nat. Bank & Trust Co. v. Chicago, R. I. & P. R. R., 294 U. S. 648 (1935).

29. The process provision was added as part of the Act of Aug. 27, 1935, 49 STAT. 911 (1935), 11 U. S. C. § 205a (Supp. 1938), which made numerous changes throughout § 77. The decision in the *Rock Island* case was handed down April 1, 1935.

30. Instances of the exercise of this power are given in Robertson v. Railroad Labor Board, 268 U. S. 619, 624 (1925).

It may be argued that it is inequitable to compel parties to come into the reorganization court to defend suits brought by the trustee and that in some cases it may be cheaper for them to suffer default judgments than to defend suits far from their residences. The argument, however, has little weight in view of the fact that there are very few suits brought by railroads or their trustees on small claims.[31] The principal case, which involved over $3,000,000, cannot be justified on the ground that undue hardship would have been imposed upon the defendants by compelling them to come into the reorganization court to present their defenses. The requirement that all suits *against* railroads which are undergoing reorganization must be brought in the reorganization court regardless of the residence of the plaintiff[32] would seem to impose equal hardship. Yet no serious objections seem to have been made to it.

The instant decision runs counter to the unquestioned purpose of Section 77 to make reorganization more efficient by centralizing proceedings in one court. The defendants resided in New York, Cleveland, Kansas City and St. Joseph, a fact well illustrating the difficulties which will arise from an unnatural interpretation of the process provision. Unless the process of the court is held to run throughout the country and the court is given jurisdiction over plenary actions, separate suits will have to be brought within the venue of each of these defendants.[33] Considerations of justice, convenience and economy demand that one court should decide the entire controversy, rather than that the issues should be disposed of piecemeal in several jurisdictions.

31. Though no statistics appear to be available, a cursory examination of digested cases indicate that in practically all the cases in which railroads are involved they are parties defendant. Cases such as the present where the railroad is plaintiff are relatively rare.

32. The "exclusive jurisdiction" conferred upon the reorganization court by subdivision (a) of § 77 prevents all other courts from determining controversies relating to the object of such jurisdiction. *See* Gerdes, *supra* note 4, at 288.

33. Although the plaintiff was permitted under § 57 of the Judicial Code to bring an action in the western district of Missouri, where the property had situs, damages against the defendants beyond the value of the property could not be rendered in such an *in rem* action. Thompson v. Terminal Shares, 89 F. (2d) 652 (C. C. A. 8th, 1937); Thompson v. Murphy, 93 F. (2d) 38 (C. C. A. 8th, 1937). *See* 36 STAT. 1102 (1911), 28 U. S. C. § 118 (1934). In suits to enforce liens, service under this provision may be made outside the district or by publication upon a defendant "not an inhabitant of or found within the district." Although no lien existed in the principal case before the suit, a bill to impose and foreclose a lien on the stock and notes in the western district of Missouri has been held to come under this section. *See* Spellman v. Sullivan, 61 F. (2d) 787 (C. C. A. 2d, 1932); 1 MOORE'S FEDERAL PRACTICE (1938) §§ 4.35, 4.37.

INTEREST OF CREDITORS IN GOODS HELD BY A BANKRUPT FOR SALE*

A RECENT decision in the Circuit Court of Appeals for the Second Circuit has pointed anew the problems faced by courts in defining the rights of creditors to claim merchandise supplied to an insolvent dealer under contracts reserving title in the manufacturer.[1] For some years the defendant had sold flour to the bankrupt for manufacture and sale as macaroni; but as the financial condition of the bankrupt had grown unstable, the defendant made a contract with the bankrupt that the latter thereafter in their dealings was to act as defendant's agent, without title to the flour, and that the proceeds upon sale were to be kept separate for the defendant's account. In spite of the strict terms of the contract, however, the course of business between the two parties remained substantially unchanged. In an action by the trustee in bankruptcy against defendant to recover damages for conversion of assets of the bankrupt, the circuit court reversed a directed verdict for the defendant, holding that, inasmuch as the parties had not actually carried out the terms of the contract,[2] the transaction was really one of absolute sale, and under the law of New York,[3] the reservation of title was void as to creditors.[4]

Such attempts to reserve title are popular; reflecting the efforts of manufacturers to bolster a dealer's credit by continuing to supply goods to preserve the dealer's business as a distributing unit, and at the same time to avoid loss of the merchandise in the dealer's bankruptcy by maintaining the equivalent of a secret lien against his creditors.[5] Contracts which have been

* Louis Liebowitz, as Trustee in Bankruptcy of Peter Cassinelli Macaroni Co., Inc. v. Frank Voiello, N. Y. L. J., Dec. 2, 1939, p. 1915, col. 1 (C. C. A. 2d, Nov. 13, 1939).

1. Liebowitz v. Voiello, N. Y. L. J., Dec. 2, 1939, p. 1915, col. 1 (C. C. A. 2d, Nov. 13, 1939).

2. The provisions of the contract are discussed in note 25 *infra*.

3. The trustee in bankruptcy may avoid any transfer by the bankrupt of his property which any creditor might have avoided. Creditors' rights are determined by applying the law of the state in which the bankruptcy court sits. 52 STAT. 879 (1938), 11 U. S. C. §§ 110 (a), (e) (Supp. 1938). Hence variations in results among the federal courts are common. Hewitt v. Berlin Machine Works, 194 U. S. 296 (1904). For a criticism of this rule, *see* ELKUS AND GLENN, SECRET LIENS AND REPUTED OWNERSHIP (1910) § 29.

4. In the following cases, relied on by the court in the principal case, attempted agencies were held to be absolute sales: Taylor v. Fram, 252 Fed. 465 (C. C. A. 2d, 1918); Yarm v. Lieberman, 46 F. (2d) 464 (E. D. N. Y. 1931). *See also In re* Leflys, 229 Fed. 695 (C. C. A. 7th, 1916); *In re* Carpenter, 125 Fed. 831 (N. D. N. Y. 1903). The leading case on the point, in which an agency contract was sustained, is Ludvigh v. American Woolen Co., 231 U. S. 522 (1913).

5. Attempts to reserve title because of the unstable credit of those with whom the manufacturer is obliged to deal, were first made in marketing farm supplies in agricultural regions. If the manufacturer extended credit on outright sales, he was likely to lose the goods to creditors and have only a valueless action against the judgment-proof dealer. *See* Klaus, *Sale, Agency and Price Maintenance, II* (1928) 28 COL. L. REV. 441; VEBLEN, ABSENTEE OWNERSHIP (1923) 142 *et seq.* Similar attempts are general in commission merchandising of perishable foods. 1 NEWTON, PRACTICAL AND LEGAL ASPECTS OF CONSIGNMENT MARKETING (1935) 1-3. In some cases this method of distribution may

devised to serve these purposes vary widely in detail, but most of them resemble chattel mortgages, conditional sales, agencies and bailments for sale, or trust receipts. Analysis of decisions disposing of these agreements indicates that often cases have been decided by fitting the device into the technical category it most resembles, the rights of creditors being defined according to principles applicable to that category. This strict conceptualism has frequently led courts to overlook the important fact that in all these contracts there has been a uniform purpose—to create a secret reservation of title. Disregard of this common denominator has produced variations in results, even within a single jurisdiction,[6] which seem clearly unjustified in view of the uniform public policy against secret liens. Furthermore, a curious omission by the legislature in the New York Conditional Sales Act[7] has contributed to the confusion in that state. The difficulties in which the courts now find themselves may be effectively illustrated by analyzing in turn each of the categories into which these transactions have been fitted.

First, the manufacturer who supplies goods to a failing concern is not likely to conform his contract to a chattel mortgage, since an unrecorded chattel mortgage is void as to all creditors in New York, and as to lien creditors in most other states.[8] Publicity of recordation is not desired, because it may accelerate the destruction of the dealer's credit, and consequently his value to the manufacturer as a distributor.[9] Furthermore, even a recorded agreement which gives the mortgagor power to sell the mortgaged property is fraudulent *per se* as to creditors in New York, unless the proceeds are retained by the mortgagor in a separate fund and a strict accounting rendered the mortgagee[10]—conditions too stringent for the average commission merchant.[11] The method provided by statute in New York for avoiding this rigid rule is likewise of little value to the manufacturer, since it protects a mortgagee only after compliance with burdensome and virtually impossible

be more profitable to the manufacturer, apart from the improvement in his position as against the dealer's creditors. *Id.*, at 2. For devices used to accomplish similar purposes in instalment selling, *see* Adelson, *Mechanics of the Instalment Credit Sale* (1935) 2 LAW & CONTEMP. PROB. 218.

6. Although this Note is mainly concerned with the treatment of the problem in New York, much of the case law of that state is typical, and the ideas developed here have general application.

7. N. Y. PERS. PROP. LAW §§ 60-80. *See* p. .... and note 20 *infra*.

8. N. Y. LIEN LAW §§ 230, 230-a. For the rule in other states, *see* 3 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES (Bower's ed. 1933) §§ 245, 245a. In states where only lien creditors are protected the manufacturer may secure a secret lien by delaying recordation. *Ibid.* The use of such a device is unlikely, however, for the manufacturer would not be willing to assume the risk involved.

9. This motive has been frequently noticed by the courts. *See In re* Eichengreen, 18 F. (2d) 101, 103 (C. C. A. 5th, 1927).

10. Skilton v. Codington, 185 N. Y. 80, 77 N. E. 790 (1906); Hangen v. Hachemeister, 114 N. Y. 566, 21 N. E. 1046 (1889); Brackett v. Harvey, 91 N. Y. 214 (1883); Boice v. Finance Co., 127 Va. 563, 102 S. E. 591 (1920). The rule in other states is discussed in 2 JONES, *op. cit. supra* note 8, at § 459; Note (1927) 49 A. L. R. 1495.

11. The lax business methods and irresponsibility of commission merchants are discussed in 2 NEWTON, *op. cit. supra* note 4, at 43.

notification requirements as to each of the dealer's creditors.[12] At common law in New York the rule was equally strict: the lien of a mortgagee who permitted the sale of the mortgaged goods in the regular course of trade was void as to creditors.[13]

More frequently, the manufacturer has resorted to a conditional sale, reserving title to the goods until they are sold and paid for by the dealer.[14] In states having statutes rendering conditional sales void as to creditors unless filed,[15] a decision that the intentionally unfiled contract is a conditional sale defeats the purpose of the manufacturer. Under the Uniform Conditional Sales Act, an unfiled conditional sale is invalid as to lien creditors regardless of whether the parties contemplate a resale.[16] But in New York, owing to a peculiar omission in the statute, it seems that the manufacturer who uses an unrecorded conditional sale for resale would be successful against creditors of the dealer. The provisions of the Uniform Act as to conditional sales for resale were not adopted in that state. Section 65 of the New York statute declares unfiled conditional sales void as to creditors of the vendee, but, unlike the Uniform Act, excepts conditional sales for resale from the operation of that section.[17] Section 69 provides for conditional sales for resale, declaring them "valid whether filed or not except that the reservation of property shall be void against purchasers from the buyer in good faith for value and without actual knowledge of the condition of such contract."[18] An unfiled agreement of conditional sale is therefore valid as to creditors if it be for resale, but invalid if resale is not expressly or impliedly provided. This result is directly contrary to the common law rule in New York declaring that a conditional sale for resale is fraudulent as a matter of law with respect to creditors as well as innocent purchasers, because resale is considered inconsistent with the ownership of the vendor and a fraud upon cred-

12. N. Y. LIEN LAW § 230-a. In *In re* Rosom Utilities, Inc., 25 F. Supp. 626 (E. D. N. Y. 1938) the argument that Section 230-a does not apply to a purchase-money mortgage seems indefensible.

13. Divver & Gunton v. McLaughlin, 2 Wend. 596 (N. Y. 1829). And *see* cases cited *supra* note 10.

14. Some courts and writers argue that since both chattel mortgages and conditional sales are security devices there is no real distinction between them. "It seems to me a barren distinction . . . that title does not pass upon a conditional sale; 'title' is a formal word for a purely conceptual notion; I do not know what it means and I question whether anybody does, except perhaps legal historians." L. Hand, J., dissenting in *In re* Lake's Laundry, Inc., 79 F. (2d) 326, 328 (C. C. A. 2d, 1935). *But see* Glenn, *The Conditional Sale at Common Law and as a Statutory Security* (1939) 25 VA. L. REV. 559, 570.

15. Various recording requirements applying to conditional sales are enforced in at least forty-two states. For a survey of these statutes, *see* 3 JONES, *op. cit. supra* note 8, §§ 1008-1056. The Uniform Conditional Sales Act has been adopted in at least ten states since it was introduced in 1919. *Ibid.*

16. UNIFORM CONDITIONAL SALES ACT §§ 5, 9. 2 GREEN, UNIFORM LAWS ANNOTATED (1922) 6. Since only lien creditors are protected against unfiled conditional sales under the Uniform Act, delayed filing might enable the manufacturer to maintain a secret lien. Morey & Co. v. Schaad *et al.*, 98 N. J. L. 799, 121 Atl. 622 (1923). But this device seems impracticable. *See* note 8 *supra.*

17. N. Y. PERS. PROP. LAW § 65.

18. N. Y. PERS. PROP. LAW § 69.

itors of the vendee.[19] Section 64 reinforces this ludicrous result by stating that "every . . . conditional sale . . . shall be valid as to all persons, except as hereinafter otherwise provided."[20]

Thus in New York, legislative omission has contributed to confusion in the treatment of secret liens. But in most jurisdictions the reaction of the courts to manufacturers' efforts to evade creditors by relying on doctrines of agency has been a source of even greater contradiction. The manufacturer has attempted to draw contracts enabling him to preserve against the dealer the absolute obligation to pay of a conditional sale, and at the same time to escape creditors by declaring the dealer to be a mere agent without title to the goods in his possession. Since possession implied ownership at common law, possession for sale without ownership was in bad faith on its face and created a false credit.[21] But goods held by the bankrupt as agent or bailee were not available to creditors, such possession for sale being doctrinally consistent with the ownership of the principal.[22] Furthermore, a bailment with permission to sell was not generally created as a security device for a prolonged course of dealing.[23] The courts are not prone to pierce the doctrine by noticing the probability that goods held by a bankrupt, who has not advertised himself as agent, may create a false credit as easily as goods subject to a secret lien; and the argument that the dealer is an agent has been persuasive.[24]

19. *In re* Garcewich, 115 Fed. 87 (C. C. A. 2d, 1902); Smith v. Mishawaka Woolen Mfg. Co., 172 Fed. 98 (C. C. A. 7th, 1909) (applying the law of Wisconsin); Troy Wagon Works v. Hancock, 152 Fed. 605 (C. C. A. 7th, 1906) (applying law of Indiana); *In re* Agnew, 178 Fed. 478 (S. D. Miss. 1909); Devlin v. O'Neill, 6 Daly 305 (N. Y. 1875), *aff'd*, 68 N. Y. 622 (1877); Ludden v. Hazen, 31 Barb. 650 (N. Y. 1860); *cf.* Ballard v. Burgett, 40 N. Y. 314 (1869).

But the majority rule is *contra*. Mishawaka Woolen Mfg. Co. v. Westveer, 191 Fed. 465 (C. C. A. 6th, 1911); UNIFORM CONDITIONAL SALES ACT §§ 5, 9.

It seems that in New York a conditional sale for manufacture may be valid at common law against creditors although a conditional sale for resale is void. Prentiss Tool and Supply Co. v. Schirmer, 136 N. Y. 305, 32 N. E. 849 (1892); Barrett v. Pritchard, 2 Pick. 512 (Mass. 1824).

20. N. Y. PERS. PROP. LAW §§ 64, 65, 69. Apparently the legislature desired to imitate the form of the Uniform Act by treating conditional sales for resale in a separate section, but to extend its protection by incorporating in that section the New York common law; thus safeguarding both creditors and innocent purchasers regardless of filing, in a section where the Uniform Act follows the majority rule and protects only innocent purchasers when the contract is filed. Hence conditional sales for resale were exempted from the general rule in Section 65, which leaves all conditional sales valid as to creditors if filed, but by error creditors were omitted from the protection intended to be given in Section 69.

21. Twyne's Case, 3 Co. 80 b (K. B. 1601).

22. *Ex Parte* Wingfield, L. R. 10 Ch. Div. 591 (1879); Mace v. Cadell, 1 Cowp. 232 (K. B. 1774) (agency for sale not within English "reputed ownership" statute, (1623) 21 Jac. 1, ch. 19, §§ 10, 11); McCullough v. Porter, 4 W. & S. 177 (Pa. 1842).

23. *See* note 22 *supra*. *See* Comment (1932) 31 MICH. L. REV. 558, 562.

24. Ludvigh v. American Woolen Co., 231 U. S. 522 (1913); Sturm v. Boker, 150 U. S. 312 (1893); *In re* Klein, 3 F. (2d) 375 (C. C. A. 2d, 1924); *In re* Galt, 120 Fed. 64 (C. C. A. 7th, 1903); Baker v. New York Nat. Exchange Bank, 100 N. Y. 31, 2 N. E. 452 (1885); Cole v. Mann, 62 N. Y. 1 (1875).

However, the manufacturer has been unwilling to assume full responsibility as a principal, and most contracts relying on an agency to thwart creditors have included provisions resembling an absolute or conditional sale to the dealer rather than an "agency" or "consignment." Although the good faith of the manufacturer in declaring that the dealer is an agent is the test the courts purport to apply in determining the validity of such hybrid schemes,[25] the manufacturer has been permitted in some degree to be a vendor with respect to the dealer, and at the same time to be protected against creditors as a principal.[26] When the dealer must keep and pay for goods unsold, or when he may mingle the proceeds of goods sold with his own funds, it is generally held that the dealer is not an agent.[27] But contracts requiring the dealer to keep goods unsold at the option of the manufacturer,[28] or permitting him to fix selling prices over which the manufacturer has no control,[29] are sustained as agencies, although it seems clear, as the court suggested in the principal case, that there is no agency in good faith in the strict sense, and that the manufacturer is a party to a device which may enable the dealer to obtain a false credit.[30] From the practical point of view of creditors,

25. Cases applying the good faith standard are cited *supra* note 24. Bad faith may appear in two ways: (1) the contract may reveal an intent to set up a bona fide agency, but if the parties do not carry out the contract the transaction will be judged by what they actually did. Liebowitz v. Voiello, N. Y. L. J., Dec. 2, 1939, p. 1915, col. 1 (C. C. A. 2d, 1939); Taylor v. Fram, 252 Fed. 465 (C. C. A. 2d, 1918).

Even though the parties carry out the contract its terms may reveal that no bona fide agency was actually intended. In the principal case, Liebowitz v. Voiello, *supra,* even if the provisions of the contract had been carried out there would be some doubt as to its validity with respect to creditors, since failure to include provisions for return of flour unsold or segregation of proceeds would suggest bad faith.

26. Contracts providing for this dual position were sustained as to creditors in the cases cited *infra* note 28. But some courts have refused to tolerate such agreements. *In re* Roellich, 223 Fed. 687 (D. Ore. 1915). In Snelling v. Arbuckle Bros., 104 Ga. 362, 365, 30 S. E. 863 (1898) the court said the contract "appears to have been drawn for the purpose of enabling Arbuckle Bros. to 'run with the hare or hold with the hounds' according as, in the exigencies of a given case, their interests might dictate."

27. Ludvigh v. American Woolen Co., 231 U. S. 522 (1913); Notes (1929) 63 A. L. R. 355, (1922) 17 A. L. R. 1421.

28. McCallum v. Bray-Robinson Clothing Co., 24 F. (2d) 35 (C. C. A. 6th, 1928); Mitchell Wagon Co. v. Poole, 235 Fed. 817 (C. C. A. 6th, 1916).

29. This provision is very common. The majority rule declares that there is an agency even though the dealer has complete control over the resale price. Ludvigh v. American Woolen Co., 231 U. S. 522 (1913). The English rule is *contra. See* the thorough analysis in *Ex parte* White, L. R. 6 Chanc. App. 397 (1870).

30. The Circuit Court of Appeals for the Second Circuit has shown some impatience with this result. Thus in Liebowitz v. Voiello, N. Y. L. J., Dec. 2, 1939, p. 1915, col. 1 (C. C. A. 2d, 1939), the court said: "It is not readily apparent why any consignment arrangement is not a secret lien against creditors of a shaky consignee, as harmful as an unfiled chattel mortgage or conditional sale." *See also* comment of L. Hand, J. (now Circuit Judge) in *In re* Weisl et al., 300 Fed. 635, 639 (S. D. N. Y. 1924). In Liebowitz v. Voiello, *supra,* the court deemed itself bound by Ludvigh v. American Woolen Co., 231 U. S. 522 (1913). A reconsideration of that decision seems desirable in the light of the argument in the text. There has been a significant shift in public policy in favor of creditors in this type of situation, especially with respect to conditional sales, since the

there is little difference between these arrangements and an outright sale subject to a purchase-money mortgage: both are security devices. This tendency to uphold "agency" contracts, which are as likely to deceive creditors as unfiled conditional sales or chattel mortgages, suggests that in the application of the good faith standard to consignment devices the courts have conceded too much to the pressure of business practice. The attention of the court is often centered on the relation between the dealer and the manufacturer, leaving the actual position of creditors a secondary factor.

A possible rationale for a rule more favorable to creditors lies in the equitable doctrine of estoppel. The dealer's possession may be considered a representation by the manufacturer that he has no prior lien, which he is estopped to deny in the face of a creditor who has acted in reliance on the reputed ownership of the dealer.[31] But the precedents applying the bad faith standard are numerous, and the courts do not usually initiate reforms of long-standing rules, however desirable they may be. A more practicable alternative is suggested by statutes like that of Virginia, which declare that goods held by the agent are available to his creditors unless he publishes the name of his principal in the newspapers and on a sign posted conspicuously at his place of business.[32] The public policy against secret liens, which produced the statutes declaring the validity of chattel mortgages and conditional sales contingent on recordation, applies with equal force to consignment arrangements, which in this situation are analogous to secret liens. The welfare of commission merchandising does not require that the manufacturer be permitted to deceive creditors by clothing the dealer with the indicia of ownership.

The extension in the use of trust receipts to domestic transactions, notably in financing the distribution of automobiles,[33] suggests another alternative possibly open to the manufacturer which involves no risk to him.[34] He may sell the goods to a bank or other financing agent which advances the price as the proceeds of a loan to the dealer. In return for the dealer's trust receipt reserving title in the bank as security for the loan, the dealer is permitted to hold the goods for sale. The Second Circuit has recognized that the bank has merely a security interest in the goods, and has sustained the title of the bank whenever it procures the goods from a party other than the seller, on the theory that a trust receipt is *sui generis:* neither a chattel mortgage nor a conditional sale.[35] However it has been effectively argued that

Ludvigh decision. Other lower federal courts have been reluctant to follow the doctrine there stated. *See* Note (1929) 63 A. L. R. 355, 374.

31. The doctrine is discussed in ELKUS AND GLENN, *op. cit. supra* note 3, §§ 38-52.

32. VA. CODE ANN. (Michie & Sublett, 1936) § 5224. Maryland, Mississippi and West Virginia have adopted similar statutes. MD. ANN. CODE (Bagley, 1924) art. 2, §§ 18, 20; MISS. CODE ANN. (1930) § 3352; W. VA. CODE ANN. (Michie & Sublett, 1937) § 4654.

33. This development is discussed in LLEWELLYN, CASES ON SALES (1930) 763-765. For the authoritative general treatment of trust receipts, *see* Frederick, *The Trust Receipt as Security* (1922) 22 COL. L. REV. 395.

34. It should be noted, however, that the value of the trust receipt device to the manufacturer in a situation similar to that in the principal case may be greatly decreased by the reluctance of banks to engage in credit transactions with a small merchant whose credit rating is not high.

35. *In re* James, Inc., 30 F. (2d) 555 (C. C. A. 2d, 1929).

the possibility of deception of third parties is not less when the bank acquires title from a third party than when the goods are shipped directly to the dealer who gives security title to the bank.[36] Yet the latter device is invalid,[37] whereas the former is frequently sustained. As in the consignment cases the criterion deciding creditors' rights is less concerned with the real position of the creditors than with the relations between the parties to the agreement.[38] A modification in doctrine looking to the limitation of the domestic use of trust receipts,[39] or the enactment of recording statutes applicable to them,[40] seems desirable. Such action would be in accord with the public policy protecting creditors against unfiled conditional sales, and in conjunction with the reform suggested with respect to agency contracts would go far toward achieving the uniform treatment of the problem which appears desirable.[41]

TRANSFER OF ASSETS PENDING STAY OF EXECUTION AS CONTEMPT OF COURT*

THE judgment debtor who strips himself of his assets pending a stay of execution seriously hampers the successful litigant in the enforcement of his judgment. Transfer of property by a debtor under such circumstances will give the judgment creditor an action for fraudulent conveyance;[1] but to secure the benefit of his judgment in such an action the creditor must discover the grantee and prove a case of fraud. Since this means of recovery is often slow and cumbersome, judgment creditors have occasionally sought

36. *See* 1 WILLISTON, SALES (2d ed. 1924) § 338a.

37. *In re* A. E. Fountain, Inc., 282 Fed. 816 (C. C. A. 2d, 1922).

38. This approach is illustrated in Federal Finance Corp. v. Reed, 296 Fed. 1 (C. C. A. 1st, 1924).

39. *See* LLEWELLYN, *op. cit. supra* note 33, 765.

40. The Uniform Trust Receipts Act, which provides that unrecorded trust receipts are invalid as against a trustee in bankruptcy, has been adopted in nine states, including New York. N. Y. PERS. PROP. LAW §§ 51, 58 (3) (a). And *see* 9 UNIFORM LAWS ANNOTATED (Supp. 1938) 214.

For criticism of application of recording requirements to trust receipts, *see* Hanna, *Trust Receipts* (1931) 19 CALIF. L. REV. 257, 273; Comment (1933) 31 MICH. L. REV. 558, 563.

41. This discussion assumes the major premise of the courts: that possession of goods by dealers without title will mislead creditors. But increasing use of credit bureau ratings suggests that in fact creditors may not be misled by secret liens as frequently as the doctrine assumes. However, such revaluation of fundamental assumptions behind hostility to secret liens must await further research into business practice, and is beyond the scope of this Note. *See* LLEWELLYN, *op. cit. supra* note 33, 765.

*Berry v. Midtown Service Corporation, 104 F. (2d) 107 (C. C. A. 2d, 1939), *cert. granted,* 60 Sup. Ct. 114 (U. S. 1939).

1. Maasch v. Parkin *et al.*, 58 App. Div. 560, 69 N. Y. Supp. 187 (2d Dep't 1901).

an alternative remedy through a civil contempt citation against the debtor,[2] on the theory that the employment by the latter of a stay of execution as a respite in which to effect a fraudulent conveyance carries a definite connotation of affront to the court, and that inherent in the court's order of stay is a direction that the parties must maintain the status quo and do nothing during that time to jeopardize each other's position.[3] More specifically, the defendant is alleged to be subject to an implied order not to impair his financial responsibility.[4]

The desirability of a contempt citation under these circumstances stems from the fact that the contemnor is ordered to pay a fine to the injured party as indemnity.[5] In the case of a transfer of assets the fine will be the amount of the judgment which was rendered ineffective. Should this remedial fine not be paid, the contemnor will be committed to prison until payment is made.[6] Thus contempt proceedings, resulting in the summary recovery of the value of the judgment under threat of imprisonment, become in these instances a most effective creditor's remedy.

In a recent case in the Circuit Court of Appeals for the Second Circuit, a judgment creditor, whose debtor had transferred his assets pending a stay of execution, sought to utilize this contempt procedure.[7] The court, however, held the remedy inappropriate, on the ground that the acts complained of did not constitute "disobedience or resistance to any lawful writ, process, order, rule, decree, or command" as required by the Federal Contempt Statute.[8] Construing the Statute as restrictive legislation and expressing itself as bound by its terms, the court refused to include within its provisions orders allegedly existing only by implication.

Both the language of the Statute[9] and its historical background[10] lend support to this strict interpretation, but such literal compliance has not always

2. Lineker v. Dillon, 275 Fed. 460 (N. D. Cal. 1921); Gresswell v. O'Rourke, 163 N. Y. Supp. 580 (Sup. Ct. 1917). On the difference between civil and criminal contempt, see Note (1936) 46 YALE L. J. 326.

3. Lineker v. Dillon, 275 Fed. 460 (N. D. Cal. 1921).

4. Jedeikin v. Long, 154 Misc. 835, 278 N. Y. Supp. 464 (Sup. Ct. 1935).

5. Dakota Corp. v. Slope County, 75 F. (2d) 584 (C. C. A. 8th, 1935); Campbell *et al.* v. Arkansas-Missouri Power Co., 65 F. (2d) 425 (C. C. A. 8th, 1933); Campbell v. Motion Picture Machine Operators, 151 Minn. 238, 186 N. W. 787 (1922).

6. Landry v. Landry, 215 App. Div. 316, 213 N. Y. Supp. 671 (1st Dep't 1926), RAPALJE, CONTEMPT (1884) § 130.

7. Berry v. Midtown Service Corp., 104 F. (2d) 107 (C. C. A. 2d, 1939), *cert. granted,* 60 Sup. Ct. 114 (U. S. 1939).

8. 36 STAT. 1163 (1911), 28 U. S. C. § 385 (1934).

9. "The said courts shall have power to impose and administer all necessary oaths, and to punish, by fine or imprisonment, at the discretion of the court, contempts of their authority. Such power to punish contempts shall not be construed to extend to any cases except the misbehavior of any person in their presence, or so near thereto as to obstruct the administration of justice, the misbehavior of any of the officers of said courts in their official transactions, and the disobedience or resistance by any such officer, or by any party, juror, witness, or other person to any lawful writ, process, order, rule, decree, or command of the said courts."

10. The Statute in its present form was passed in 1831 following the impeachment trial of District Judge Peck. The judge had cited one Lawless for contempt as punish-

been shown. The doctrine that the contempt power is inherent in the courts has weakened the effect of legislative restrictions on it.[11] In *United States v. Toledo Newspaper Company*,[12] a case involving contempt by publication, the Supreme Court stated that the Statute was merely declaratory and "conferred no powers not already granted, and imposed no limitations not already existing."[13] This interpretation was followed in *Lineker v. Dillon*,[14] a district court case, where there had been a transfer of assets pending a stay of execution. No order to maintain the status quo had been issued, but, interpreting the Statute broadly, the court held that such an order was implied from the stay, and the judgment debtor was held in contempt for its violation under the court's inherent contempt power unrestrained by the Statute. The court in the *Berry* case, however, declined to follow *Lineker v. Dillon*, differing both as to the construction of the Statute, and specifically, as to whether the transfer was in contempt. Even though the *Berry* case did not involve contempt by publication, about which the history and subsequent interpretation of the Statute have centered, its view of the Statute as being restrictive is a pertinent and commendable reflection of a judicial attitude towards the general function of the legislation.[15]

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ment for a publication adversely criticizing an opinion. The impeachment failed, but public opinion, remembering the alien and sedition laws, demanded a legislative check on further abuses of the summary power. The result was the present Statute. See Frankfurter and Landis, *Power of Congress over Procedure in Criminal Contempts in "Inferior" Federal Courts* (1924) 37 HARV. L. REV. 1010; Nelles and King, *Contempt by Publication in the United States* (1928) 28 COL. L. REV. 401, 525, THOMAS, PROBLEMS OF CONTEMPT OF COURT (1934).

11. Any historical basis for the doctrine of "inherent power" has been removed by Sir John Fox in THE HISTORY OF CONTEMPT OF COURT (1927), where it is shown that contrary to the assertions of Blackstone [4 BL. COMM. *286] "immemorial usage" does not sustain the power. Nevertheless courts still reassert the doctrine, as its convenience impels its retention. The federal statute has succumbed to this doctrine by having the "so near thereto" clause construed to refer to obstructive effect rather than physical proximity. *See* THOMAS, *op. cit. supra* note 10, at 64. *See also* Comment (1938) 48 YALE L. J. 54, at 58.

12. 247 U. S. 402 (1918).

13. *See* Kreplik v. Couch Patents Co., 190 Fed. 565, 572 (C. C. A. 1st, 1911) where the Statute is said to be a legislative assertion of the inherent contempt power of the courts.

14. 275 Fed. 460 (N. D. Cal. 1921).

15. The relegation of the Statute to declaratory impotency has been heartily criticized as a clear departure from its plain meaning and intent. *See* Frankfurter and Landis *supra* note 10, at 1029, and Nelles and King *supra* note 10, at 543.

In *Ex parte* Robinson, 19 Wall. 505 (U. S. 1873) the Supreme Court construed the Statute as a valid restriction on the contempt powers of the inferior federal courts. The construction in the *Toledo Newspaper* case was given without reference to Ex parte *Robinson*. The later date of the *Toledo Newspaper* case may give it a stronger position as authority, yet the true status of the statute is still doubtful. In Morgan v. United States, 95 F. (2d) 830 (C. C. A. 8th, 1938) the interpretation in Ex parte *Robinson* was followed, and the assertion was made that it did not appear that the Supreme Court had ever receded from its interpretation in that case. For other instances of strict interpretation since the *Toledo Newspaper* case, *see* McCann v. New York Stock Exchange, 80 F. (2d) 211, 213 (C. C. A. 2d, 1935); Wilson v. United States, 26 F. (2d) 215, 218 (C. C. A. 8th, 1928).

Apart from general interpretation of the Statute, the specific point at issue in the instant case, namely, whether the implied order to maintain the status quo could have been included within the meaning of the statutory term "order," is dependent upon a consideration of the status of implied orders in contempt proceedings. There is authority for punishing as contempt, in the absence of any actual order, acts in the nature of a disobedience, but except for decisions in New York,[16] which has a broad contempt statute,[17] the instances where it has been done involved different operative facts from those in the *Berry* and *Lineker* cases. Where a person anticipates the issuance of an order and proceeds to do that which the order will forbid, such an act has been held a contempt. In *Ex Parte Kellogg*[18] the contemnor had been the defendant in an action to require the turning over of certain personal property to the sheriff. He secured a continuance, and in that time disposed of the property in anticipation of an adverse order. In *State ex rel. Morse v. District Court*[19] a chief of police was held in contempt for the delivery of a prisoner to extradition messengers in anticipation of the service of a writ of habeas corpus. In these cases there is the element of an inchoate order and an anticipatory breach of its terms. Neither element can be found in the *Berry* case. Further, the destruction or removal pending suit of the subject matter of the litigation, thereby rendering any forthcoming judgment meaningless, has been held a contempt.[20] Here, though no actual order has been issued, some specific property constructively in the custody of the court is involved. It has also been held that the filing of a petition in bankruptcy effects an attachment of the debtor's property, and hence a subsequent transfer is a contempt.[21] However, the stay of execution in the situation presented by the *Berry* case is not so analogous to a petition in bankruptcy as to compel the conclusion that such an encumbrance attaches to the assets of the judgment debtor.

16. Gresswell v. O'Rourke, 163 N. Y. Supp. 580 (Sup. Ct. 1917); Advance Piece Dye Works, Inc. v. Zeller, 150 Misc. 908, 270 N. Y. Supp. 487 (N. Y. City Ct. 1934); Silverman v. Seneca Realty Co., 154 Misc. 35, 276 N. Y. Supp. 466 (Sup. Ct. 1934); Jedeikin v. Long, 154 Misc. 835, 278 N. Y. Supp. 464 (Sup. Ct. 1935). *Contra:* Dollard v. Koronsky, 67 Misc. 90, 121 N. Y. Supp. 987 (Sup. Ct. 1910), *aff'd*, 138 App. Div. 213, 123 N. Y. Supp. 11 (1st Dep't 1910), *aff'd*, 199 N. Y. 558, 93 N. E. 1119 (1910).

17. N. Y. JUD. LAW § 753.

18. 64 Cal. 343, 30 Pac. 1030 (1883).

19. 29 Mont. 230, 74 Pac. 412 (1903).

20. Merrimack Bank v. Clay Center, 219 U. S. 527 (1911) (removal of telegraph equipment from streets pending appeal from dismissal of bill to restrain removal); Wartman v. Wartman, 29 Fed. Cas. No. 17,210 (C. C. D. Md. 1853) (disposition of trust corpus by party in possession pending determination of rights in it); Bartholomay Brewing Co. v. O'Brien, 172 App. Div. 784, 159 N. Y. Supp. 126 (4th Dep't 1916), *aff'd*, 220 N. Y. 587, 115 N. E. 1033 (1917) (sublease of premises pending action to establish a lien and foreclose same upon a liquor tax certificate); Winichi v. Silverman, 163 N. Y. Supp. 634 (Sup. Ct. 1917) (retransfer of automobiles pending action to set aside transfer to defendant); But *cf.* Dakota Corp. v. Slope County, 75 F. (2d) 584 (C. C. A. 8th, 1935).

21. Clay v. Waters, 178 Fed. 385 (C. C. A. 8th, 1910) (interference by third party); *In re* Mardenfield, 256 Fed. 920 (N. D. N. Y. 1919) (sale and appropriation by bankrupt). *Contra: In re* Probst 205 Fed. 512 (C. C. A. 2d, 1913).

Finally, where a court has issued a decree declaring a property status, it has been held in some cases that any acts inconsistent with such a declaration are in contempt.[22] This issue arises especially in cases of water rights where a party appropriates more than his decreed share.[23] Although none of these authorities present a square analogy, they do represent the doctrine that a formal order is not an invariable requisite.

In spite of these cases where a formal order has been dispensed with, there is considerable authority to indicate that such an order will generally be required. It has been held that contempt will lie only for disobedience to what is decreed, not to what may be decreed;[24] further that there must be a disobedience to a decree or order in existence.[25] Even where there has been the issuance of an actual order, courts will not cite for contempt unless the acts alleged to constitute the disobedience fall clearly within the acts enjoined.[26] It is necessary that the order cover the act; expansion of an existent decree by implication is improper.[27] It is difficult to reconcile such strictness with theories implying an order in its entirety. The cases where this has been done are better viewed as exceptions to the general principle requiring the order to be express.

Where a court process has been used as an opportunity to effectuate fraud, it can readily be argued that the court as well as the party aggrieved has an interest in rectifying the damage. However, there is a certain harshness in an extension of the practice of using the contempt power to punish a disobedience to an order which was in fact never expressly issued. In the stay of execution cases the order is said to exist by implication; yet an order to the plaintiff not to levy execution is far from an obvious basis for implying an order to the defendant to conserve his assets. Moreover, the efficacy of the remedy in the hands of the creditor depends on the removal of certain protections normally given the debtor: jury trial is dispensed with and the

22. In Hotaling v. Superior Court, 191 Cal. 501, 217 Pac. 73 (1923) where the court declared a party to be owner of certain stock and entitled thereto, the officers of the corporation refused to cancel the certificate of the prior owner and issue a new one to the successful litigant. They were held not to be in contempt as the order only declared a right and gave no direction to them.

23. State *ex rel.* Zosel v. District Court, 56 Mont. 578, 185 Pac. 1112 (1919); Ophir Creek Water Co. v. Ophir Hill Consolidated Mining Co., 61 Utah 551, 216 Pac. 490 (1923). *Contra:* Albrethson v. Ensign, 32 Idaho 687, 186 Pac. 911 (1920).

24. *Ex parte* Buskirk, 72 Fed. 14 (C. C. A. 4th, 1896); *In re* Probst, 205 Fed. 512 (C. C. A. 2d, 1913).

25. United States v. Day, 25 Fed. Cas. No. 14,934 (C. C. D. N. J. 1858); Federal Trade Commission v. Fairyfoot Products Co., 94 F. (2d) 844 (C. C. A. 7th, 1938); Epstein v. American Hammond Piston Ring Co., 95 N. J. Law 391, 113 Atl. 319 (Sup. Ct. 1921).

26. Terminal R.R. Ass'n of St. Louis *et al.* v. United States, 266 U. S. 17 (1924); *In re* Cary, 10 Fed. 622 (S. D. N. Y. 1882); McFarland v. United States, 295 Fed. 648 (C. C. A. 7th, 1924); *In re* Miller and Harbaugh, 54 F. (2d) 612 (C. C. A. 9th, 1931); Mitchell v. Sperling, 229 App. Div. 204, 241 N. Y. Supp. 543 (1st Dep't 1930); North *et al.* v. Foley, 149 Misc. 572, 267 N. Y. Supp. 572 (Sup. Ct. 1933).

27. Terminal R.R. Ass'n of St. Louis *et al.* v. United States, 266 U. S. 17 (1924); Lustgarten v. Felt & Tarrant Mfg. Co., 92 F. (2d) 277 (C. C. A. 3d, 1937).

creditor gains the ultimate sanction of subjecting the debtor to imprisonment. Then too, the implied order to maintain the status quo effects an attachment of the debtor's property during the stay. Logically, a conveyance by the debtor need not even be fraudulent, as a transfer which impairs financial responsibility is a violation of a duty to maintain the status quo. In any event imposition of this duty would postpone an inclination on the part of the debtor to pay other obligations, through fear of being cited for an alteration of his financial position. Such substantial advantages should not accrue to a judgment creditor merely because a stay of execution has been granted the debtor.

A denial of a remedy in civil contempt on a theory of an implied order to maintain the status quo does not leave the creditor without protection against the danger of fraudulent conveyances. The expedient of a stay bond is available, and where such security cannot be obtained, a request for an actual order may be made.[28] There is no injustice in refusing to grant such an order retrospectively for the benefit of one who made no request for it when the stay was granted.

CANCELLATION OF GROUP INSURANCE POLICY BY EMPLOYER WITHOUT CONSENT OF EMPLOYEE*

THE problem of determining the validity of cancellation of a group insurance policy by an employer without the employee's consent had until recently been uniformly resolved by examining the status of the employee under the contract between employer and insurer,[1] and predicating the result on a determination of whether or not the employee was a party to that contract. The majority of the courts have held he was not such a party, and have therefore sustained the cancellation and denied recovery to the named beneficiary.[2] A recent Ohio decision,[3] allowing recovery by the use of analogy from old-line[4] insurance cases, constitutes a challenge to the validity of the rationale of all previous decisions on the subject, and to the correctness of the actual results reached under the majority rule.

In *Hinkler v. Equitable Assurance Society*,[5] the insured employee, Hinkler, held individual certificates under two annual policies of group insurance

28. It must be conceded that such an order might be refused. See Scott v. Neely, 140 U. S. (1891); Martin v. James B. Berry Sons' Co., 83 F. (2d) 857 (C. C. A. 1st, 1936). However, inability invariably to secure such an order on request only militates further against a doctrine by which the order arises automatically by implication.

*Hinkler v. Equitable Life Assurance Society, 22 N. E. (2d) 451 (Ohio App. 1938).

1. *See* note 26 *infra*. *But cf.* Butler v. Equitable Life Ass. Soc., 93 S. W. (2d) 1019 (Munic. Ct. Mo. 1936).

2. *See* note 27 *infra*.

3. Hinkler v. Equitable Life Ass. Soc., 22 N. E. (2d) 451 (Ohio App. 1938).

4. The term "old-line" insurance is used in this Note to distinguish cases involving standard life insurance policies from those dealing with group insurance.

5. 22 N. E. (2d) 451 (Ohio App. 1938).

in which his wife was named as beneficiary. On one policy[6] the employer paid all the premiums; the other was contributory, with the employee paying a share. Both policies gave the employee the power to change the beneficiary and the privilege to convert his group insurance to an individual policy if he left the job. Each certificate clearly stated that it was as much a part of the insurance contract as was the master policy between employer and insurer.[7] When these policies had still some months to run, the employer negotiated for their termination and the issuance of a new master policy. Upon receiving notice of cancellation, Hinkler applied for a certificate under the proposed new policy. He died, however, after the time for paying the last installment on the old policy had passed, without payment, but within the grace period which was provided.[8] Hinkler's wife, refusing to recognize that Hinkler's actions in applying for a certificate under the new policy constituted the consent allegedly required for effective cancellation, brought suit on the old policies.

The court allowed her full recovery. Dismissing as immaterial the different rationale of previous group cases on the point, the court adopted the traditional principle that the beneficiary of an insurance policy has a vested interest which, although defeasible by lapse,[9] may not be destroyed by cancellation.[10] Both the employee Hinkler and his wife were regarded as beneficiaries—Hinkler because of the potential benefit he might receive by exercising his privilege to convert to an individual policy—and both were held in consequence to have rights that the policy should not be cancelled without their affirmative consent. As to Hinkler, there is support for the court's position, at least by inference, in the old-line insurance cases cited in the opinion. By analogy to the principles of those cases, Hinkler seems to be, as the court found, a beneficiary under both policies and so a necessary party to their cancellation. On the contributory policy he appears, because of his joint financial responsibility for it, to have, as well, the rights of an insured. On this assumption Hinkler and the employer shared as to one policy the status of insured parties; their right to cancel it was joint, not to be exercised without the consent of both.

The court, however, did not stop with its determination of Hinkler's status, but went on to consider whether the wife had independent rights against cancellation. Since the power to change the beneficiary was here reserved, it would seem that the wife could have independent rights against cancellation only on the authority of those old-line cases holding a beneficiary's rights in

6. The word "policy" will be used in this Note to refer to the master policy between insurer and employer, not to the individual certificate held by each employee.

7. "This policy [certificate], together with the employer's application therefor . . . shall constitute the entire contract between the parties." Brief for Respondent, at 4.

8. The grace clause is acknowledgedly sufficient in lapse cases, to keep the policies alive for thirty-one days after payment was due. The central issue in the principal case is whether the employer and insurer can, by cancellation, make this grace clause inoperative.

9. 2 COUCH, CYCLOPEDIA OF INSURANCE LAW (1929) 824; VANCE, INSURANCE (2d ed. 1930) 545.

10. VANCE, *op. cit. supra* note 9, at 543; 7 COOLEY, BRIEFS ON INSURANCE (2d ed. 1928) 6399; 2 COUCH, *op. cit. supra* note 9, § 308.

the policy vested until a proper exercise of the power;[11] under the larger number of cases holding her interest a mere expectancy,[12] her consent seems immaterial. The court, in holding Mrs. Hinkler's consent necessary, ignored this conflict in the authorities by citing as its only precedent a case in which the power to change the beneficiary had *not* been reserved.[13] The instant case, therefore, provides an unconvincing precedent on this point. A more convincing argument could be made by *distinguishing* the expectancy cases: since the employee was the only one with power to change the beneficiary, it might well be said that the wife's rights were vested as to the employer, so that, with regard to cancellation by him, the case would fall within the principle of cases in which power to change the beneficiary had *not* been reserved.[14] In this case, however, the wife does not need, in order to recover, an independent right that the policy should not be cancelled without her consent. If it be granted that the policy remained in force because Hinkler's consent was missing, the wife, whose right to sue for the benefits was vested by her husband's death,[15] should recover.

The problem of the wife's independent rights illustrates the complexity and difficulty of applying traditional insurance law to group insurance. The mere fact of having another party to the contract prevents any exact parallel with orthodox insurance cases, except for a very few, which, since they deal only with the question of insurable interest, provide no precedent.[16] The comparison is further weakened by the fact that the presence of the employer has considerably changed the status which the employee would have under a regular policy. The employee has become a limited beneficiary;[17] and some of the normal functions he would have as an insured have been assumed by the employer.[18] Because of the necessities of a master policy covering a large number of employees, the employer occupies a curious middle position between the insurer and employees[19]—a position giving rise to intricate agency problems with regard to his responsibility for transmission of premiums[20]

11. VANCE, *op. cit. supra* note 9, at 561.

12. 2 COUCH, *op. cit. supra* note 9, at 825; VANCE, *op. cit. supra* note 9, § 147.

13. Union Central Life Ins. Co. v. Buxer, 62 Ohio St. 385, 57 N. E. 66 (1900), *cited in* Hinkler v. Equitable Life Ass. Soc., 22 N. E. (2d) 451, 452 (Ohio App. 1938).

14. But see Stoner v. Equitable Life Ass. Soc., 28 Dauphin Co. Rep. 235, 238 (Pa. 1925).

15. 2 COUCH, *op. cit. supra* note 9, at 825; VANCE, *op. cit. supra* note 9, at 564.

16. *See* McCann v. Metropolitan Life Ins. Co., 177 Mass. 280, 58 N. E. 1026 (1901); Sullivan v. Metropolitan Life Ins. Co., 174 Mass. 467, 54 N. E. 879 (1899); Burke v. Prudential Ins. Co., 155 Pa. 295, 26 Atl. 445 (1893).

17. Through the potential benefit which might accrue to Hinkler from the exercise of his conversion privilege. *See* Hinkler v. Equitable Life Ass. Soc., 22 N. E. (2d) 451, 453 (Ohio App. 1938).

18. Notably, payment of premiums and initial procurement of the policy.

19. For a detailed discussion of the employer's position in group insurance, *see* Hanft, *Group Insurance: Its Legal Aspects* (1935) 2 LAW & CONTEMP. PROB. 70; and, in less detail, Comment (1936) 36 COL. L. REV. 89.

20. Deduction by the employer of part of the employee's wages constitutes payment to insurer. All States Life Ins. Co. v. Tilman, 226 Ala. 245, 146 So. 393 (1933); Deese v. Travelers Ins. Co., 204 N. C. 214, 167 S. E. 797 (1933); Missouri State Life Ins. Co.

and notice of loss[21] to insurer, and notice of termination of the insurance[22] to the employees. These new problems are in part consequences of the industrial character of group insurance. Group insurance is primarily conditioned upon employment factors: its inauguration is largely motivated by the desire to improve employee morale,[23] its amount generally increases with years of service,[24] and it ends altogether when the employee loses his job. To meet the new problems which arise in this complex setting, a new approach to the insurance contract in group cases seems required.

All courts, in the situation of the instant case, had undertaken such a reanalysis,[25] and had approached the problem on a straight contract basis. They had dealt with the policy as a contract between employer and insurer; but most courts have failed to regard the employee as a party to the contract, and have treated him as a third party beneficiary who does not have the rights of the traditional insurance beneficiary[26] to enforce the policy where cancellation

v. Compton, 73 S. W. (2d) 1079 (Tex. Civ. App. 1934). *Cf.* Sun Life Ass. Co. v. Coker, 187 Ark. 602, 61 S. W. (2d) 447 (1933).

21. The employer is not the insurer's agent for receiving proof of loss. Ammons v. Equitable Life Ass. Soc., 205 N. C. 23, 169 S. E. 807 (1933).

22. The employee is not entitled to notice of termination of insurance. Beecey v. Travelers Ins. Co., 267 Mass. 135, 166 N. E. 571 (1929); Magee v. Equitable Life Ass. Soc., 62 N. D. 614, 244 N. W. 518, 85 A. L. R. 1457 (1932); Thull v. Equitable Life Ass. Soc., 40 Ohio App. 486, 178 N. E. 850 (1931) (probably overruled by principal case). But *cf.* Deese v. Travelers Ins. Co., 204 N. C. 214, 167 S. E. 797 (1933).

Nor is the employee entitled to notice of termination of employment—which terminates the insurance. Colter v. Travelers Ins. Co., 270 Mass. 424, 170 N. E. 407 (1930); Aetna Life Ins. Co. v. Lembright, 32 Ohio App. 10, 166 N. E. 586 (1928) (probably overruled by the principal case). *Contra:* Emerick v. Connecticut Gen'l Life Ins. Co., 120 Conn. 60, 179 Atl. 335 (1935). The question of the employer's intent to discharge the employee may be left to the jury. Cogsdill v. Metropolitan Life Ins. Co., 158 S. C. 371, 155 S. E. 747 (1930).

23. CRAWFORD, GROUP INSURANCE (1936) 6; Comment (1936) 36 COL. L. REV. 89, 91; (1934) 12 N. C. L. REV. 166, 168.

24. Hinkler's non-contributory policy automatically increased in amount by one hundred dollars every year for five years. Defendant's brief on motion to certify to Supreme Court of Ohio, at p. 58.

25. *But cf.* Butler v. Equitable Life Ass. Soc., 93 S. W. (2d) 1019 (Munic. Ct. Mo. 1936).

26. Larocco v. Equitable Life Ass. Soc., 68 Fed. (2d) 451 (C. C. A. 3d, 1933); Meyerson v. New Idea Hosiery, 217 Ala. 153, 115 So. 94, 55 A. L. R. 1231 (1927); Carruth v. Aetna Life Ins. Co., 157 Ga. 608, 122 S. E. 226 (1924); Carpenter v. Chicago R. R., 21 Ind. App. 88, 51 N. E. 493 (1898); Peyton v. Metropolitan Life Ins. Co., 148 So. 721 (Ct. App. La. 1933); Beecey v. Travelers Ins. Co., 267 Mass. 135, 166 N. E. 571 (1929); 8 COUCH, *op. cit. supra* note 9, § 2094; CRAWFORD, GROUP INSURANCE (1936) 30; Hanft, *op. cit. supra* note 19, at 85; Comment (1936) 36 COL. L. REV. 89, 96; *cf.* Emerick v. Connecticut Gen'l Life Ins. Co., 120 Conn. 60, 179 Atl. 335 (1935). Of course the old-line insurance beneficiary is a mere third party beneficiary himself, but he has been accorded, for special reasons, rights independent of and adverse to the insured's rights under the policy. *See* Vance, *Beneficiary in a Life Insurance Policy* (1922) 31 YALE L. J. 343. However, the employee in group insurance, viewed as a third party beneficiary, is considered to have no rights not specifically provided for his benefit in the insurance policy. *See* notes 27, 28 *infra.*

is without his consent.[27] Nor is the employee entitled to notice of cancellation under the majority rule,[28] though he or his appointed beneficiary may sue for benefits due on the policy.[29] It is probably the apparent inequity of denying recovery on the policy after Hinkler's long reliance[30] on it for his insurance, and his inability to prevent the attempted reduction, that induced the court in the instant case to rely on the older, vested interest rationale. In order to avoid inequity, however, it was not necessary to abandon the contract rationale of previous group cases; a better way would have been to follow the lead of some recent cases in correcting the errors in analysis in the majority rule.[31] A few courts have properly reasoned that the employee is an implied party to the insurance contract by virtue of his certificate.[32] The consideration necessary to support a contract by Hinkler with the employer and insurer is clearly present, on the contributory policy, in the premiums paid.[33] On the non-con-

27. Austin v. Metropolitan Life Ins. Co., 142 So. 337 (Ct. App. La. 1932) (non-contributory); Stoner v. Equitable Life Ass. Soc., 28 Dauphin Co. Rep. 235 (Pa. 1925) (non-contributory); Thompson v. Pacific Mills, 141 S. C. 303, 139 S. E. 619 (1927) (non-contributory); Davis v. Metropolitan Ins. Co., 161 Tenn. 655, 32 S. W. (2d) 1034 (1930) (contributory); Missouri State Life Ins. Co. v. Hinkle, 74 S. W. (2d) 1032 (Ct. App. Tenn. 1934) (contributory). The holding in these cases, however, do not square with the facts: In the *Austin* and *Stoner* cases the policies had lapsed by the time of the employee's death; in the *Thompson* and *Davis* cases a previous recovery had been had on the new policy; in the *Hinkle* (and *Stoner*) cases the employee, having lost his job, was no longer covered by the insurance. The *Davis* and *Hinkle* cases appear, anyway, to be overruled by Smithart v. John Hancock Mut. Life Ins. Co., 167 Tenn. 513, 71 S. W. (2d) (1934).

But those cases which hold that the employee is not entitled to notice of cancellation are [*see* note 22 *supra*], *a fortiori*, authority against the proposition that an employee's consent is required for cancellation. Even where notice is required, on the other hand, it does not follow that consent must be given. Sowell v. Travelers Ins. Co., 207 N. C. 372, 177 S. E. 15 (1934).

28. *See* note 22 *supra*.

29. This rule is universal. The employer need not be made a party to suit against insurer. *See* Hamblin v. Equitable Life Ass. Soc., 124 Neb. 841, 248 N. W. 397 (1933).

30. For seventeen years Hinkler was insured under group policies and at the time of his death carried $10,000 insurance. Brief for Respondent, pp. 1, 2.

31. Or the court might have held the cancellation invalid as an attempt to evade the spirit of the Ohio Statute which required a grace clause in all insurance contracts. Spencer v. Cleveland Athletic Ass'n, 32 Nisi Prius 369 (Munic. Ct. Ohio 1934). *See* note 8 *supra*.

32. Williams v. John Hancock Mut. Ins. Co., 154 Misc. 504, 277 N. Y. Supp. 429 (Sup. Ct. 1935); Smithart v. John Hancock Mut. Ins. Co., 167 Tenn. 513, 71 S. W. (2d) 1059 (1934); *see* Schuerman v. General American Ins. Co., 106 S. W. (2d) 920, 924, (Munic. Ct. Mo. 1937); Spencer v. Cleveland Athletic Ass'n, 32 Nisi Prius 369 (Munic. Ct. Ohio 1934) (alternative holding) *semble*.

33. Williams v. John Hancock Mut. Ins. Co., 154 Misc. 504, 277 N. Y. Supp. 429 (Sup. Ct. 1935); Smithart v. John Hancock Mut. Ins. Co., 167 Tenn. 513, 71 S. W. (2d) 1059 (1934); CRAWFORD, *op. cit. supra* note 23, at 22, 99, 180; Hanft, *op. cit. supra* note 19, at 85; Comment (1936) 36 COL. L. REV. 89, at 97, 98, 102; *accord*, Emerick v. Connecticut Gen'l Life Ins. Co., 120 Conn. 60, 179 Atl. 335 (1935); Butler v. Equitable Life Ass.

tributory policy, there would seem to be consideration in the fact that the insurance given is partial compensation for services[34]—as is emphasized by the provision for an increase in insurance with each additional year of employment. There seems, therefore, a sound basis for giving Hinkler, as a direct party to the contract, rights against cancellation without his consent. And once this is granted, the wife's right to recover seems clear without any consideration of whether she had any independent right against cancellation. She need only show that the policy was still in force at her husband's death, when her right to recover against the insurance company matured.

The majority of courts in group cases seem justified in avoiding the older vested interest rationale which is based on fact situations at best superficially parallel to those in group insurance. Ironically enough, the court in the instant case achieved by the use of the vested interest analogy a more equitable result than it could have attained by following the majority rule under the more apt contract rationale. It would have been just as fair and far more appropriate had the court followed the minority recent cases, adopting the contract rationale but considering the employee a party to the insurance contract. This would have equally protected the parties, but by the use of principles which seem better suited to the greater complexity of the modern industrial setting of group insurance.

INTERVENTION BY CREDITOR OF SUBSIDIARY COMPANY IN REORGANIZATION OF PARENT*

IT was long recognized that, as a device for corporate reorganization, the equity receivership was deficient in certain important respects. Prominent among these were the jurisdictional limitations of the reorganization forum,[1] and the court's inability to examine the plan of reorganization at an early stage to insure its feasibility and fairness.[2] Section 77B and its successor,

Soc., 93 S. W. (2d) 1019 (Munic. Ct. Mo. 1936); *see* Schuerman v. General American Insurance Co., 106 S. W. (2d) 920, 924 (Munic. Ct. Mo. 1937).

Today the overwhelming majority of group policies are contributory and the proportion is increasing. 7 ENCYC. SOC. SCIENCES 184 (1932); Comment (1936) 36 COL. L. REV. 89, 91.

34. Spencer v. Cleveland Athletic Ass'n, 32 Nisi Prius 369 (Munic. Ct. Ohio 1934); CRAWFORD, *op. cit. supra* note 23, at 22, 180; Hanft, *op. cit. supra* note 19, at 85, 86; Comment (1936) 36 COL. L. REV. 89, 98; (1934) 12 N. C. L. REV. 166, 168; *see* Thompson v. Pacific Mills, 141 S. C. 303, 139 S. E. 619 (1927); *cf.* First National Bank & Trust Co. v. Comm'r of Internal Revenue, 39 B. T. A. 134 (1939).

Or the contract may be based on the employee's action in reliance where he is promised insurance so long as he stays on the job. Restatement, Contracts (1932) § 90. *But see* Colter v. Travelers Ins. Co., 270 Mass. 424, 431, 170 N. E. 407, 409 (1930); Myerson v. New Idea Hosiery, 217 Ala. 153, 115 So. 94, 55 A. L. R. 1231 (1927).

* Commercial Cable Staffs' Association v. Robert Lehman *et al.*, C. C. A. 2d, Nov. 20, 1939.

1. 1 GERDES ON CORPORATE REORGANIZATIONS (1936) § 14.

2. *Id.* § 16.

Chapter X of the Bankruptcy Act, were enacted with the express purpose of obviating such defects. But a recent decision of the Circuit Court of Appeals for the Second Circuit raises a question as to whether in some situations these statutory provisions have effectuated any real improvement over the technique of the equity receivership.

Proceedings were instituted under Section 77B for the reorganization of two holding companies, one of which, the Postal Telegraph and Cable Company, owned all the common and a substantial part of the preferred stock in the other, the "Associated Companies." None of the other subsidiaries or affiliates in the extensive system of which the debtors formed a part had been technically in reorganization, nor had they at any time submitted themselves to the jurisdiction of the court. The plan, however, provided for a thorough reshuffling of inter-company holdings and properties, which was to be effected by votes cast by the debtor holding companies as stockholders in the subsidiaries. Cable Staffs' Association, a body composed of the employees of one of the subsidiaries, sought to intervene in the reorganization proceedings on the plea that its interests were adversely affected by the proposed plan.[3] It was interested in Commercial Cable Company, its employer, as a creditor only through certain pension claims, which in a large part depended upon the existence of profits;[4] it asserted, *inter alia*,[5] that the plan would strip Commercial of all its liquid assets and thereby render insolvent the new company which was to succeed it and to assume the pension claims, thus constituting a conveyance which would be fraudulent as to the trade union.[6]

3. When the assets of a solvent subsidiary of the debtor are to be sold or transferred as part of a reorganization plan, unless the creditors of the subsidiary company suspect some fraud on them, they have no standing to object. ROHRLICH, LAW AND PRACTICE IN CORPORATE CONTROL (1933) 174. But careful provision is generally made in the plan for satisfying their claims. *Cf. In re* Warner-Quinlan Co., Inc., 17 F. Supp. 659 (S. D. N. Y. 1936), (1937) 37 COL. L. REV. 863.

4. Although in this Note it will be assumed arguendo that the union members may properly be called "creditors" of Commercial, their status is actually somewhat ambiguous. There are no accrued liabilities under the pension scheme, since payments are being made currently during the reorganization. The pension reserves are not clearly a "liability;" classified in the books as a reserve, they may best be characterized as a mere bookkeeping entry. Record on Appeal, p. 206, and Exhibit 16, n. 9. Viewed as parties to an executory contract—perhaps an unwarranted interpretation, since the employees contribute nothing and the employer reserves the right to change the scheme at any time—it may be that the employees are not "creditors" until their contract has been rejected. *See* BANKRUPTCY ACT § 202, 52 STAT. 893-4 (1938), 11 U. S. C. § 602 (Supp. 1938); but *cf.* the broad definitions of "claims" and "creditor" in § 106 (1), (4), 52 STAT. 883 (1938), 11 U. S. C. § 506(1), (4) (Supp. 1938). Under the debtors' reorganization plan, the pension schemes are being carried in full onto the books of the new company. Record on Appeal, pp. 826-7.

5. Its objection that the plan was unfair because of the preponderant control which it gave to the International Telephone and Telegraph Corp., sole common stockholder of Postal, was not dealt with in the court's opinion. See note 14 *infra*.

6. A principal feature of the plan is the transfer of the assets of Commercial Cable, a solvent subsidiary, to weaker parts of the system. The financial relations of Commercial Cable with the two debtors are as follows: Associated owns all the shares in Commercial, and Commercial owes 23 million dollars to Postal and owns 12½% of the pre-

In the district court, the union lost on the merits. The Second Circuit, speaking through Judge Learned Hand, in a two to one decision, dismissed the appeal for want of jurisdiction on the ground that the union was not a "creditor" of either debtor subject to the jurisdiction of the court, and hence should not have been allowed to intervene.[7]

The majority suggests that assumption of jurisdiction might be proper if necessary to prevent "palpable fraud." But from an examination of probable Congressional intent as revealed in the statute, it concludes that exercise of jurisdiction in this case would unduly expand the meaning of Section 77B (and Chapter X); and that, insofar as the scope of the equity powers of a reorganization tribunal were concerned, the grievances of the would-be intervener, the trade union, could be handled more expeditiously in another court.

The reorganization sections of the Bankruptcy Act are dedicated to the adjustment of relations between the debtor, its shareholders and creditors. Judge Hand construes this as excepting by implication the adjudication of claims arising between the subsidiary and its own creditors, the subsidiary not having petitioned for reorganization.[8] Therefore, he maintains that even though the stockholders of the parent may be identical with those of the subsidiary, nevertheless the latter's creditors have no interest in the parent's reorganization, because their rights are against different assets.[9] Judge Hand believes this interpretation is borne out by the provision requiring a separate petition to be filed for a subsidiary in order to join it in the reorganization of its parent.[10] Such a provision would be unnecessary if the subsidiary's creditors were already within the jurisdiction of the bankruptcy tribunal.[11]

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ferred shares of Associated, which are worthless because of Associated's insolvency. Under the plan, the debt to Postal and other obligations to the system are to be cancelled in consideration of Commercial's surrender of its various stock holdings, of 38 million dollars of accounts receivable from affiliated companies, and of 3 millions in cash. The last item has caused the union the most concern, but it is an extraordinary accumulation due to the fact that Commercial has been enjoined from paying interest on the debt to Postal since the beginning of the reorganization proceedings. But by the same token, the cash reserves of Commercial have been depleted by the non-payment of interest owing to it by other companies.

With the exceptions above, the assets of Commercial are to be transferred to a new company, when they will be burdened with 8 million dollars of bonded indebtedness.

7. *Cf. In re* Northeastern Water Companies, Inc., 24 F. Supp. 653 (N. D. N. Y. 1938).

8. The court did not consider the possibility that Congress might not have the constitutional power to provide for the adjudication of claims between such parties, in view of the traditional confinement of bankruptcy jurisdiction to the adjustment of claims between a bankrupt and its creditors.

9. The corporate entities would be disregarded only if it were necessary for the protection of the rights of innocent parties, or if the subsidiary were a mere adjunct, completely dominated by its parent. *Cf.* Taylor v. Standard Gas & Electric Co., 306 U. S. 307 (1939); Trustees System Co. of Pa. v. Payne, 65 F. (2d) 103 (C. C. A. 3d, 1933).

10. BANKRUPTCY ACT § 129, 52 STAT. 886 (1938), 11 U. S. C. § 529 (Supp. 1938); *cf.* § 77B(a), 48 STAT. 912 (1934), 11 U. S. C. § 207(a) (1934). See note 12 *infra*.

11. The majority further demonstrates that while the Act solicitously guards the interests of creditors of the debtor, it makes no provision regarding the interests of others. The dissent contends in reply that the union may be included within the broad definition

The court seems to argue that in a situation in which it is unnecessary for a subsidiary to be a party to the reorganization of the parent, there is no need to hear objections raised by adversely affected creditors of the subsidiary.[12] But in its analysis of the statute, the court fails to utilize two significant provisions, one relating to intervention, and the other to the feasibility of the plan.

A broad provision of Chapter X, which could be made applicable to this proceeding,[13] clearly permits intervention[14] to "a party in interest generally or with respect to any specified matter."[15] Inquiries into the union's status as a "creditor" of the debtor or even of the subsidiary could be held irrelevant. The union may possess legitimate claims against the debtor, even if those claims are not sufficient to give it creditor status. The debtor Associated was the sole stockholder of Commercial and might have been enjoined by any creditor of Commercial from completing a threatened fraudulent withdrawal of assets. This claim against the debtor should make the union a

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of "creditor" of one of the debtors, *i.e.*, "the holder of any claim," BANKRUPTCY ACT § 106(4), 52 STAT. 883 (1938), 11 U. S. C. § 506(4) (Supp. 1938); it is a "potential" creditor of the debtor Associated, if its allegations as to an impending fraudulent conveyance are true. It would seem, however, that a potential creditor is none at all.

12. But although a separate petition must be filed for the reorganization of the subsidiary, it does not follow that there is no jurisdiction over a solvent subsidiary for any purpose. *In re* Associated Gas & Electric Co., 11 F. Supp. 359 (N. D. N. Y. 1935) (subsidiaries of the debtor enjoined from transferring their assets out of the regular course of business, except after reasonable notice to the court and creditors).

13. See BANKRUPTCY ACT § 276c(2), 52 STAT. 905 (1938), 11 U. S. C. § 676c(2) (Supp. 1938), which provides that if the petition for reorganization was approved more than three months before the effective date of the new Act, the provisions of Chapter X shall apply to the pending proceedings "to the extent that the judge shall deem their application practicable." See note 27 *infra*.

14. Compare with § 207, note 15 *infra*, FED. RULES CIV. PROC. 24(a)(3), which, substantially restating federal practice under old Equity Rule 37, provides an *absolute* right to intervene "when the applicant is so situated as to be adversely affected by a distribution or other disposition of property in the custody of the court or of an officer thereof." The language in Chapter X is permissive, but so was the wording of old Equity Rule 37. For the view that under some circumstances the right to intervene in a reorganization proceeding *pro interesse suo—i.e.*, to protect rights in property in the custody of the court—should be absolute, see FINLETTER, THE LAW OF BANKRUPTCY REORGANIZATION (1939) 594-599; 2 MOORE'S FEDERAL PRACTICE (1938) § 24.10; see also MOORE, *id.* §§ 24.08, 24.09. See note 16 *infra*.

Pursuing the analogy of intervention *pro interesse suo*, it would seem that the trade union in the principal case, if permitted to intervene, would be heard only on the transfer of Commercial's assets, and no more. See note 5 *supra*; FINLETTER, *supra*, at 596. Yet, it may be argued that piecemeal examination of the plan would be artificial.

15. BANKRUPTCY ACT § 207, 52 STAT. 894 (1938), 11 U. S. C. § 607 (Supp. 1938). Section 77B(c)(11), 48 STAT. 917 (1934), 11 U. S. C. § 207(c)(11) (1934), permits intervention by creditors and stockholders in a limited number of situations. But a broad construction of the provision was recommended. Levi and Moore, *Federal Intervention* (1936) 45 YALE L. J. 565. See Rowan v. Harburney Oil Co., 91 F. (2d) 122 (C. C. A. 10th, 1937); Central Hanover Bank & Trust Co. v. Philadelphia & Reading C. & I. Co., 99 F. (2d) 642 (C. C. A. 3d, 1938).

"party in interest" with respect to the consummation of the plan, and hence entitled to intervene.

And once the power to allow intervention has been admitted, exercise of that power in any given case becomes a matter of judicial discretion.[16] Of course, intervention is a privilege which must be carefully guarded. In each case it will be necessary to weigh the comparative importance of insuring the interested parties a hearing, against the policy of keeping down aimless filibustering in order to effect a prompt reorganization. But in the principal case, it seems that the court should have permitted the trade union to intervene; for a suit instituted by the rejected intervener in another tribunal to prevent the consummation of the plan could seriously threaten the success of the reorganization.[17] The facts in the instant case were such that confirmation by the reorganization court could not have the desired finality so long as the union's claim remained unsettled.[18] When interpreted as a device which should be perfected to obviate the necessity for independent determinations of related issues, the right to intervene or to be heard[19] in reorganization cases is in keeping with the spirit of modern procedure, which, as the dissent points out, "aims to view matters in their entirety, . . . and also to put an end to litigation as promptly and as completely as possible."

The further provision which merited the attention of the majority was the requirement, present both in Section 77B and Chapter X, that before confirming a plan the judge must be satisfied that it is "feasible."[20] The decision

16. See Globe Grain & Mill. Co. v. American Marine Prod. Co., 91 F. (2d) 380 (C. C. A. 9th, 1937). Reference to "absolute" rights to intervene, note 14 *supra*, means only that in certain cases, a denial of permission to intervene would always be considered an abuse of discretion.

17. *In re* Adolf Gobel, Inc., 80 F. (2d) 849 (C. C. A. 2d, 1936), note 18 *infra*.

18. See note 6 *supra*. In *In re* Adolf Gobel, Inc., 80 F. (2d) 849 (C. C. A. 2d, 1936), the debtor obtained the court's approval to vote its principal asset, all the common stock in a solvent subsidiary company, towards a sale of the company's assets. A creditor of the subsidiary moved to have a sizable part of the proceeds of the sale segregated to satisfy an alleged breach of contract, and on denial of its motion, proceeded by attachment against the subsidiary in a state court. The Second Circuit reversed a restraining order of the reorganization court, on the ground that the suit was not directed against the debtor's property. But although the opinion in the *Gobel* case seems to indicate that the debtor's plan of reorganization would be fatally delimited as a consequence of the decision, it is indicated that the progress of the contract of sale was essentially unaffected by the continuance of the state court proceedings. Appellant's brief in the *Gobel* case, *supra*, pp. 31-33.

19. The Act distinguishes between the right to be heard and the right to intervene, BANKRUPTCY ACT, §§ 206-208, 52 STAT. 894 (1938), 11 U. S. C. §§ 606-608 (Supp. 1938), presumably coupling only with the latter the right to take an appeal from an adverse ruling. See 2 MOORE'S FEDERAL PRACTICE (1938) 2404; *cf.* Teton, *Reorganization Revised* (1939) 48 YALE L. J. 573, 592.

20. Section 221(2) of Chapter X, 52 STAT. 897 (1938), 11 U. S. C. § 621(2) (Supp. 1938): ". . . fair and equitable, and feasible"; *cf.* § 77B(f)(1), 48 STAT. 919 (1934), 11 U. S. C. § 207(f)(1) (1934). It might be argued that the court had to hear the union's objections in order to be satisfied that the Postal plan is "fair," a requirement bred in an atmosphere of judicial anxiety about fraudulent conveyances. But the anxiety

in the principal case drives the losing litigants into another forum to enjoin the consummation of the work of the reorganization proceeding. Under such circumstances, the fate of the plan is so uncertain that confirmation seems lacking in an essential finality.[21]

Having interpreted the relevant statutory provisions to its satisfaction, the majority then examines the power of the reorganization tribunal, sitting as an equity court, to look past technical deficiencies in the status of the union as an objecting party.[22] Here Judge Hand continues to be moved by the consideration that a reorganization court should confine itself to adjustments between the debtor, its shareholders and creditors. But he makes several significant concessions. He expressly acknowledges that on the motion of a proper party to the proceeding (which, by hypothesis, the association of Commercial's employees is not), the bankruptcy court could forbid Associated, debtor under its jurisdiction and sole shareholder of Commercial, from voting its stock to effect the allegedly fraudulent transfer. Equally significant is the statement that a bankruptcy judge should not allow a "palpable fraud" to be consummated before his eyes; "spoliation might be so patent and so gross that he would be bound to intervene *ex mero motu*." The formula which he suggests, then, reads something like this: where the status of the would-be intervener is questionable, the court should nevertheless look casually into the substance of the objection. If it spies "palpable fraud," it will take appropriate action on the merits. Thus judicial concern over the possibility of a fraudulent conveyance as an incident of a reorganization plan manifests itself in a new light; fraud as to third parties as well as to creditors of the debtor in reorganization is to be guarded against.[23] But if, as in the principal case, spoliation does not clearly appear on the face of the record, the court will dismiss on jurisdictional grounds. Technically the merits have not been considered, and the decision, consequently, is not *res judicata*.

The fact that the court could forbid Associated to vote its stock to effect a fraudulent transfer would seem to provide adequate jurisdictional basis for adjudicating the union's claim. The reorganization court has complete jurisdiction both over the controlling stockholder of the transferor and over the transferee, the newly-organized corporation which is to receive Commercial's assets. The majority's opinion stresses the fact that no decision is being made on the merits; and the trade union could at once have pursued its remedies in another tribunal free from any restraining orders of the reorganization court.[24] But the new court would unquestionably be influenced

of the courts has traditionally not extended beyond the danger of a fraudulent conveyance *as to creditors of the debtor*. Case v. Los Angeles Lumber Products Co., 60 Sup. Ct. 1 (1939).

21. *Cf.* Downtown Investment Ass'n v. Boston Metropolitan Bldgs., Inc., 81 F. (2d) 314 (C. C. A. 1st, 1936).

22. That the power of the reorganization court is not a rigid thing, narrowly circumscribed by the words of the statute, see Continental Ill. Nat. Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry., 294 U. S. 648 (1935).

23. See Case v. Los Angeles Lumber Products Co., 60 Sup. Ct. 1 (1939); Northern Pacific Ry. v. Boyd, 228 U. S. 482 (1913).

24. *Cf. In re* Adolf Gobel, Inc., 80 F. (2d) 849 (C. C. A. 2d, 1936), note 18 *supra*.

by the circuit court's findings of no "palpable fraud," and consequently the union would be unable at any time to obtain a completely unprejudiced hearing on the merits of its objection. Moreover, if Commercial should become a contractual party to the plan before the union has instituted a subsequent suit, it might be argued that Commercial was then within the jurisdiction of the court, at least for the purpose of protecting the executed arrangement, and a request for an injunction might well be granted.[25] In that case, the union would receive no opportunity at all to be heard on the merits.

It is hardly necessary to stress the inefficiency and the dangers which follow from duplication of effort by several tribunals independently acquainting themselves with the complexities of a corporate network such as that of the Postal system.[26] A subsequent suit by the trade union to enjoin the transfer of Commercial's assets, if successful, might result in a disintegration of a reorganization plan which had been years in the making.[27] Such a suit might be instituted in the same district court which has considered this case sitting as a reorganization tribunal, and might on appeal eventually return to the Second Circuit. The net effect of the so-called jurisdictional ruling must therefore be either to postpone a decision on the merits or in actuality to decide the merits without going into them so fully as the facts would seem to warrant.

25. There is some question as to the power of the reorganization court to issue orders to protect the plan executed under its supervision, if it has failed to reserve jurisdiction in the final decree for that specific purpose. *In re* Argyle-Lake Shore Corp., 98 F. (2d) 372 (C. C. A. 7th, 1938). But see *In re* Hermitage Bldg. Corp., 100 F. (2d) 597, 599 (C. C. A. 7th, 1938); consult 1 MOORE'S FEDERAL PRACTICE (1938) 467. However, the extensive powers given the court in § 262 of the Judicial Code and in § 2a(15) of the Bankruptcy Act, 52 STAT. 843 (1938), 11 U. S. C. § 11a(15) (Supp. 1938), to issue all writs, in addition to those specifically provided for, which may be necessary for the proper exercise of its jurisdiction, would seem to lend adequate sanction to a broader view. *Cf.* note 22 *supra.*

26. An alternative would have been to send the record back to be completed. There was no occasion for the court to be particularly scrupulous about the state of the record, however, since the appellant, which represented itself as the aggrieved party, was willing to take its chances on it in the form in which it was sent up on appeal.

27. Postal filed its petition for reorganization under § 77B in 1935, and the plan was first presented to the court in 1938.